

BANK OF HAWAII CORP  
Form 10-Q  
July 22, 2013

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, 2013

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  
(State of incorporation)

99-0148992  
(I.R.S. Employer Identification No.)

130 Merchant Street, Honolulu, Hawaii  
(Address of principal executive offices)  
1-888-643-3888

96813  
(Zip Code)

(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, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ☒

Accelerated filer ☐

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Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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 16, 2013, there were 44,591,814 shares of common stock outstanding.

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Bank of Hawaii Corporation  
Form 10-Q  
Index

|                                        | Page                                                                                                                        |
|----------------------------------------|-----------------------------------------------------------------------------------------------------------------------------|
| <br>Part I - Financial Information     |                                                                                                                             |
| Item 1.                                | Financial Statements (Unaudited)                                                                                            |
|                                        | <u>Consolidated Statements of Income –</u><br><u>Three and six months ended June 30, 2013 and 2012</u>                      |
|                                        | 2                                                                                                                           |
|                                        | <u>Consolidated Statements of Comprehensive Income (Loss) –</u><br><u>Three and six months ended June 30, 2013 and 2012</u> |
|                                        | 3                                                                                                                           |
|                                        | <u>Consolidated Statements of Condition –</u><br><u>June 30, 2013 and December 31, 2012</u>                                 |
|                                        | 4                                                                                                                           |
|                                        | <u>Consolidated Statements of Shareholders' Equity –</u><br><u>Six months ended June 30, 2013 and 2012</u>                  |
|                                        | 5                                                                                                                           |
|                                        | <u>Consolidated Statements of Cash Flows –</u><br><u>Six months ended June 30, 2013 and 2012</u>                            |
|                                        | 6                                                                                                                           |
|                                        | <u>Notes to Consolidated Financial Statements (Unaudited)</u>                                                               |
|                                        | 7                                                                                                                           |
| <u>Item 2.</u>                         | <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>                                |
|                                        | 43                                                                                                                          |
| <u>Item 3.</u>                         | <u>Quantitative and Qualitative Disclosures About Market Risk</u>                                                           |
|                                        | 72                                                                                                                          |
| <u>Item 4.</u>                         | <u>Controls and Procedures</u>                                                                                              |
|                                        | 72                                                                                                                          |
| <br><u>Part II - Other Information</u> |                                                                                                                             |
| <u>Item 1A.</u>                        | <u>Risk Factors</u>                                                                                                         |
|                                        | 73                                                                                                                          |
| <u>Item 2.</u>                         | <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>                                                          |
|                                        | 73                                                                                                                          |
| <u>Item 6.</u>                         | <u>Exhibits</u>                                                                                                             |
|                                        | 73                                                                                                                          |
| <u>Signatures</u>                      | 74                                                                                                                          |

Bank of Hawaii Corporation and Subsidiaries  
Consolidated Statements of Income (Unaudited)

|                                                       | Three Months Ended |            | Six Months Ended |            |
|-------------------------------------------------------|--------------------|------------|------------------|------------|
|                                                       | June 30,           |            | June 30,         |            |
| (dollars in thousands, except per share amounts)      | 2013               | 2012       | 2013             | 2012       |
| Interest Income                                       |                    |            |                  |            |
| Interest and Fees on Loans and Leases                 | \$62,729           | \$63,910   | \$125,549        | \$128,601  |
| Income on Investment Securities                       |                    |            |                  |            |
| Available-for-Sale                                    | 15,073             | 16,988     | 30,924           | 34,701     |
| Held-to-Maturity                                      | 19,189             | 25,054     | 39,043           | 51,467     |
| Deposits                                              | 1                  | 1          | 4                | 3          |
| Funds Sold                                            | 74                 | 119        | 133              | 248        |
| Other                                                 | 285                | 281        | 569              | 561        |
| Total Interest Income                                 | 97,351             | 106,353    | 196,222          | 215,581    |
| Interest Expense                                      |                    |            |                  |            |
| Deposits                                              | 2,579              | 3,219      | 5,225            | 6,692      |
| Securities Sold Under Agreements to Repurchase        | 6,751              | 7,250      | 13,756           | 14,554     |
| Funds Purchased                                       | 10                 | 5          | 32               | 10         |
| Long-Term Debt                                        | 671                | 498        | 1,309            | 996        |
| Total Interest Expense                                | 10,011             | 10,972     | 20,322           | 22,252     |
| Net Interest Income                                   | 87,340             | 95,381     | 175,900          | 193,329    |
| Provision for Credit Losses                           | —                  | 628        | —                | 979        |
| Net Interest Income After Provision for Credit Losses | 87,340             | 94,753     | 175,900          | 192,350    |
| Noninterest Income                                    |                    |            |                  |            |
| Trust and Asset Management                            | 12,089             | 11,195     | 23,975           | 22,113     |
| Mortgage Banking                                      | 5,820              | 7,581      | 12,231           | 12,631     |
| Service Charges on Deposit Accounts                   | 9,112              | 9,225      | 18,413           | 18,816     |
| Fees, Exchange, and Other Service Charges             | 13,133             | 12,326     | 25,067           | 24,725     |
| Investment Securities Losses, Net                     | —                  | —          | —                | (90        |
| Insurance                                             | 2,393              | 2,399      | 4,718            | 4,677      |
| Bank-Owned Life Insurance                             | 1,335              | 1,739      | 2,632            | 3,220      |
| Other                                                 | 4,159              | 2,383      | 8,783            | 8,838      |
| Total Noninterest Income                              | 48,041             | 46,848     | 95,819           | 94,930     |
| Noninterest Expense                                   |                    |            |                  |            |
| Salaries and Benefits                                 | 45,341             | 44,037     | 94,016           | 91,061     |
| Net Occupancy                                         | 9,661              | 10,058     | 19,296           | 20,574     |
| Net Equipment                                         | 4,380              | 4,669      | 8,957            | 10,495     |
| Data Services                                         | 3,050              | 3,160      | 6,316            | 6,747      |
| Professional Fees                                     | 2,391              | 2,386      | 4,617            | 4,518      |
| FDIC Insurance                                        | 1,949              | 2,088      | 3,898            | 4,159      |
| Other                                                 | 14,409             | 14,349     | 28,468           | 28,400     |
| Total Noninterest Expense                             | 81,181             | 80,747     | 165,568          | 165,954    |
| Income Before Provision for Income Taxes              | 54,200             | 60,854     | 106,151          | 121,326    |
| Provision for Income Taxes                            | 16,437             | 20,107     | 32,408           | 36,769     |
| Net Income                                            | \$37,763           | \$40,747   | \$73,743         | \$84,557   |
| Basic Earnings Per Share                              | \$0.85             | \$0.90     | \$1.66           | \$1.86     |
| Diluted Earnings Per Share                            | \$0.85             | \$0.90     | \$1.65           | \$1.85     |
| Dividends Declared Per Share                          | \$0.45             | \$0.45     | \$0.90           | \$0.90     |
| Basic Weighted Average Shares                         | 44,493,069         | 45,221,293 | 44,518,629       | 45,465,910 |

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|                                 |            |            |            |            |
|---------------------------------|------------|------------|------------|------------|
| Diluted Weighted Average Shares | 44,608,497 | 45,347,368 | 44,644,348 | 45,610,489 |
|---------------------------------|------------|------------|------------|------------|

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

2

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Bank of Hawaii Corporation and Subsidiaries

Consolidated Statements of Comprehensive Income (Loss) (Unaudited)

|                                                        | Three Months Ended |          | Six Months Ended |          |
|--------------------------------------------------------|--------------------|----------|------------------|----------|
|                                                        | June 30,           |          | June 30,         |          |
| (dollars in thousands)                                 | 2013               | 2012     | 2013             | 2012     |
| Net Income                                             | \$37,763           | \$40,747 | \$73,743         | \$84,557 |
| Other Comprehensive Income (Loss), Net of Tax:         |                    |          |                  |          |
| Net Unrealized Gains (Losses) on Investment Securities | (46,572 )          | 3,387    | (56,213 )        | (3,067 ) |
| Defined Benefit Plans                                  | 201                | 153      | 279              | 306      |
| Total Other Comprehensive Income (Loss)                | (46,371 )          | 3,540    | (55,934 )        | (2,761 ) |
| Comprehensive Income (Loss)                            | \$(8,608 )         | \$44,287 | \$17,809         | \$81,796 |

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

Bank of Hawaii Corporation and Subsidiaries  
Consolidated Statements of Condition (Unaudited)

| (dollars in thousands)                                                                                                                                                             | June 30,<br>2013 | December 31,<br>2012 |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------|----------------------|
| <b>Assets</b>                                                                                                                                                                      |                  |                      |
| Interest-Bearing Deposits                                                                                                                                                          | \$4,635          | \$3,393              |
| Funds Sold                                                                                                                                                                         | 329,922          | 185,682              |
| Investment Securities                                                                                                                                                              |                  |                      |
| Available-for-Sale                                                                                                                                                                 | 2,815,408        | 3,367,557            |
| Held to Maturity (Fair Value of \$4,036,197 and \$3,687,676)                                                                                                                       | 4,027,829        | 3,595,065            |
| Loans Held for Sale                                                                                                                                                                | 25,880           | 21,374               |
| Loans and Leases                                                                                                                                                                   | 5,859,152        | 5,854,521            |
| Allowance for Loan and Lease Losses                                                                                                                                                | (124,575 )       | (128,857 )           |
| Net Loans and Leases                                                                                                                                                               | 5,734,577        | 5,725,664            |
| Total Earning Assets                                                                                                                                                               | 12,938,251       | 12,898,735           |
| Cash and Noninterest-Bearing Deposits                                                                                                                                              | 136,386          | 163,786              |
| Premises and Equipment                                                                                                                                                             | 105,752          | 105,005              |
| Customers' Acceptances                                                                                                                                                             | 114              | 173                  |
| Accrued Interest Receivable                                                                                                                                                        | 43,375           | 43,077               |
| Foreclosed Real Estate                                                                                                                                                             | 3,256            | 3,887                |
| Mortgage Servicing Rights                                                                                                                                                          | 27,631           | 25,240               |
| Goodwill                                                                                                                                                                           | 31,517           | 31,517               |
| Other Assets                                                                                                                                                                       | 447,136          | 456,952              |
| Total Assets                                                                                                                                                                       | \$13,733,418     | \$13,728,372         |
| <b>Liabilities</b>                                                                                                                                                                 |                  |                      |
| <b>Deposits</b>                                                                                                                                                                    |                  |                      |
| Noninterest-Bearing Demand                                                                                                                                                         | \$3,396,835      | \$3,367,185          |
| Interest-Bearing Demand                                                                                                                                                            | 2,269,196        | 2,163,473            |
| Savings                                                                                                                                                                            | 4,433,042        | 4,399,316            |
| Time                                                                                                                                                                               | 1,350,125        | 1,599,508            |
| Total Deposits                                                                                                                                                                     | 11,449,198       | 11,529,482           |
| Funds Purchased                                                                                                                                                                    | 9,983            | 11,296               |
| Securities Sold Under Agreements to Repurchase                                                                                                                                     | 866,237          | 758,947              |
| Long-Term Debt                                                                                                                                                                     | 174,727          | 128,055              |
| Banker's Acceptances                                                                                                                                                               | 114              | 173                  |
| Retirement Benefits Payable                                                                                                                                                        | 47,318           | 47,658               |
| Accrued Interest Payable                                                                                                                                                           | 4,399            | 4,776                |
| Taxes Payable and Deferred Taxes                                                                                                                                                   | 48,947           | 88,014               |
| Other Liabilities                                                                                                                                                                  | 146,127          | 138,306              |
| Total Liabilities                                                                                                                                                                  | 12,747,050       | 12,706,707           |
| <b>Shareholders' Equity</b>                                                                                                                                                        |                  |                      |
| Common Stock (\$.01 par value; authorized 500,000,000 shares;<br>issued / outstanding: June 30, 2013 - 57,488,745 / 44,644,596<br>and December 31, 2012 - 57,319,352 / 44,754,835) | 572              | 571                  |
| Capital Surplus                                                                                                                                                                    | 518,804          | 515,619              |
| Accumulated Other Comprehensive Income (Loss)                                                                                                                                      | (26,726 )        | 29,208               |
| Retained Earnings                                                                                                                                                                  | 1,115,594        | 1,084,477            |
| Treasury Stock, at Cost (Shares: June 30, 2013 - 12,844,149                                                                                                                        | (621,876 )       | (608,210 )           |

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and December 31, 2012 - 12,564,517)

|                                            |               |               |
|--------------------------------------------|---------------|---------------|
| Total Shareholders' Equity                 | 986,368       | 1,021,665     |
| Total Liabilities and Shareholders' Equity | \$ 13,733,418 | \$ 13,728,372 |

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

Bank of Hawaii Corporation and Subsidiaries  
Consolidated Statements of Shareholders' Equity (Unaudited)

| (dollars in thousands)                                                                    | Common<br>Shares<br>Outstanding | Common<br>Stock | Capital<br>Surplus | Accum.<br>Other<br>Compre-<br>hensive<br>Income<br>(Loss) | Retained<br>Earnings | Treasury<br>Stock | Total       |
|-------------------------------------------------------------------------------------------|---------------------------------|-----------------|--------------------|-----------------------------------------------------------|----------------------|-------------------|-------------|
| Balance as of December 31, 2012                                                           | 44,754,835                      | \$571           | \$515,619          | \$29,208                                                  | \$1,084,477          | \$(608,210)       | \$1,021,665 |
| Net Income                                                                                | —                               | —               | —                  | —                                                         | 73,743               | —                 | 73,743      |
| Other Comprehensive Loss                                                                  | —                               | —               | —                  | (55,934 )                                                 | —                    | —                 | (55,934 )   |
| Share-Based Compensation                                                                  | —                               | —               | 2,732              | —                                                         | —                    | —                 | 2,732       |
| Common Stock Issued under Purchase and Equity Compensation Plans and Related Tax Benefits | 379,870                         | 1               | 453                | —                                                         | (2,235 )             | 10,294            | 8,513       |
| Common Stock Repurchased                                                                  | (490,109 )                      | —               | —                  | —                                                         | —                    | (23,960 )         | (23,960 )   |
| Cash Dividends Paid (\$0.90 per share)                                                    | —                               | —               | —                  | —                                                         | (40,391 )            | —                 | (40,391 )   |
| Balance as of June 30, 2013                                                               | 44,644,596                      | \$572           | \$518,804          | \$(26,726 )                                               | \$1,115,594          | \$(621,876)       | \$986,368   |
| Balance as of December 31, 2011                                                           | 45,947,116                      | \$571           | \$507,558          | \$35,263                                                  | \$1,003,938          | \$(544,663)       | \$1,002,667 |
| Net Income                                                                                | —                               | —               | —                  | —                                                         | 84,557               | —                 | 84,557      |
| Other Comprehensive Loss                                                                  | —                               | —               | —                  | (2,761 )                                                  | —                    | —                 | (2,761 )    |
| Share-Based Compensation                                                                  | —                               | —               | 3,723              | —                                                         | —                    | —                 | 3,723       |
| Common Stock Issued under Purchase and Equity Compensation Plans and Related Tax Benefits | 400,094                         | —               | 448                | —                                                         | (2,758 )             | 10,684            | 8,374       |
| Common Stock Repurchased                                                                  | (1,098,933 )                    | —               | —                  | —                                                         | —                    | (51,586 )         | (51,586 )   |
| Cash Dividends Paid (\$0.90 per share)                                                    | —                               | —               | —                  | —                                                         | (41,149 )            | —                 | (41,149 )   |
| Balance as of June 30, 2012                                                               | 45,248,277                      | \$571           | \$511,729          | \$32,502                                                  | \$1,044,588          | \$(585,565)       | \$1,003,825 |

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

Bank of Hawaii Corporation and Subsidiaries  
Consolidated Statements of Cash Flows (Unaudited)

|                                                                                   | Six Months Ended<br>June 30, |           |
|-----------------------------------------------------------------------------------|------------------------------|-----------|
| (dollars in thousands)                                                            | 2013                         | 2012      |
| Operating Activities                                                              |                              |           |
| Net Income                                                                        | \$73,743                     | \$84,557  |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: |                              |           |
| Provision for Credit Losses                                                       | —                            | 979       |
| Depreciation and Amortization                                                     | 6,106                        | 6,883     |
| Amortization of Deferred Loan and Lease Fees                                      | (1,807)                      | (1,548)   |
| Amortization and Accretion of Premiums/Discounts on Investment Securities, Net    | 31,996                       | 28,147    |
| Share-Based Compensation                                                          | 2,732                        | 3,723     |
| Benefit Plan Contributions                                                        | (677)                        | (5,574)   |
| Deferred Income Taxes                                                             | (4,650)                      | (11,358)  |
| Net Gains on Sales of Loans and Leases                                            | (13,938)                     | (7,542)   |
| Net Losses on Investment Securities                                               | —                            | 90        |
| Proceeds from Sales of Loans Held for Sale                                        | 445,293                      | 198,197   |
| Originations of Loans Held for Sale                                               | (438,711)                    | (189,219) |
| Tax Benefits from Share-Based Compensation                                        | (491)                        | (623)     |
| Net Change in Other Assets and Other Liabilities                                  | 22,287                       | (11,086)  |
| Net Cash Provided by Operating Activities                                         | 121,883                      | 95,626    |
| Investing Activities                                                              |                              |           |
| Investment Securities Available-for-Sale:                                         |                              |           |
| Proceeds from Prepayments and Maturities                                          | 567,569                      | 468,489   |
| Proceeds from Sales                                                               | —                            | 34,831    |
| Purchases                                                                         | (373,053)                    | (401,944) |
| Investment Securities Held-to-Maturity:                                           |                              |           |
| Proceeds from Prepayments and Maturities                                          | 569,150                      | 446,346   |
| Purchases                                                                         | (769,040)                    | (540,472) |
| Net Change in Loans and Leases                                                    | (11,483)                     | (141,526) |
| Premises and Equipment, Net                                                       | (6,853)                      | (10,755)  |
| Net Cash Used in Investing Activities                                             | (23,710)                     | (145,031) |
| Financing Activities                                                              |                              |           |
| Net Change in Deposits                                                            | (80,284)                     | 955,370   |
| Net Change in Short-Term Borrowings                                               | 105,977                      | (857,380) |
| Proceeds from Long-Term Debt                                                      | 50,000                       | —         |
| Tax Benefits from Share-Based Compensation                                        | 491                          | 623       |
| Proceeds from Issuance of Common Stock                                            | 8,076                        | 7,858     |
| Repurchase of Common Stock                                                        | (23,960)                     | (51,586)  |
| Cash Dividends Paid                                                               | (40,391)                     | (41,149)  |
| Net Cash Provided by Financing Activities                                         | 19,909                       | 13,736    |
| Net Change in Cash and Cash Equivalents                                           | 118,082                      | (35,669)  |
| Cash and Cash Equivalents at Beginning of Period                                  | 352,861                      | 669,909   |
| Cash and Cash Equivalents at End of Period                                        | \$470,943                    | \$634,240 |
| Supplemental Information                                                          |                              |           |

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|                                                                                                     |          |          |
|-----------------------------------------------------------------------------------------------------|----------|----------|
| Cash Paid for Interest                                                                              | \$21,281 | \$23,152 |
| Cash Paid for Income Taxes                                                                          | 33,554   | 41,775   |
| Non-Cash Investing Activities:                                                                      |          |          |
| Transfer from Investment Securities Available-For-Sale to Investment Securities<br>Held-To-Maturity | 254,779  | —        |
| Transfer from Loans to Foreclosed Real Estate                                                       | 2,551    | 2,309    |

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

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 (the "Company") provides a broad range of financial products and services to customers in Hawaii, Guam, and other Pacific Islands. The Parent's principal and only operating subsidiary is Bank of Hawaii (the "Bank"). All significant intercompany accounts and transactions have been eliminated in consolidation.

The accompanying unaudited consolidated financial statements of the Company 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. In the opinion of management, the consolidated financial statements reflect normal recurring adjustments necessary for a fair presentation of the results for the interim periods.

Certain prior period information has been reclassified to conform to the current period presentation.

These statements 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, 2012. Operating results for the interim periods disclosed herein are not necessarily indicative of the results that may be expected for the year ending December 31, 2013.

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.

Investment Securities

Realized gains and losses are recorded in noninterest income using the specific identification method.

Offsetting Assets and Liabilities

In December 2011, the Financial Accounting Standards Board (the "FASB") issued Accounting Standards Update ("ASU") No. 2011-11, "Disclosures About Offsetting Assets and Liabilities." This project began as an attempt to converge the offsetting requirements under U.S. GAAP and International Financial Reporting Standards ("IFRS"). However, as the FASB and International Accounting Standards Board were not able to reach a converged solution with regards to offsetting requirements, they each developed convergent disclosure requirements to assist in reconciling differences in the offsetting requirements under U.S. GAAP and IFRS. The new disclosure requirements mandate that entities disclose both gross and net information about instruments and transactions eligible for offset in the statement of financial position as well as instruments and transactions subject to an agreement similar to a master netting arrangement. ASU No. 2011-11 also requires disclosure of collateral received and posted in connection with

master netting agreements or similar arrangements. In January 2013, the FASB issued ASU No. 2013-01, "Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities." The provisions of ASU No. 2013-01 limit the scope of the new balance sheet offsetting disclosures to the following financial instruments, to the extent they are offset in the financial statements or subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in the statement of financial position: (1) derivative financial instruments; (2) repurchase agreements and reverse repurchase agreements; and (3) securities borrowing and securities lending transactions. The Company adopted the provisions of ASU No. 2011-11 and ASU No. 2013-01 effective January 1, 2013. As the provisions of ASU No. 2011-11 and ASU No. 2013-01 only impacted the disclosure requirements related to the offsetting of assets and liabilities and information about instruments and transactions eligible for offset in the statement of financial position, the adoption had no impact on the Company's consolidated statements of income and condition. See Note 5 to the Consolidated Financial Statements for the disclosures required by ASU No. 2011-11 and ASU No. 2013-01.

#### Reclassifications Out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued ASU No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income," to improve the transparency of reporting these reclassifications. ASU No. 2013-02 does not amend any existing requirements for reporting net income or other comprehensive income in the financial statements. ASU No. 2013-02 requires an entity to disaggregate the total change of each component of other comprehensive income (e.g., unrealized gains or losses on available-for-sale investment securities) and separately present reclassification adjustments and current period other comprehensive income. The provisions of ASU No. 2013-02 also require that entities present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of accumulated other comprehensive income based on its source (e.g., unrealized gains or losses on available-for-sale investment securities) and the income statement line item affected by the reclassification (e.g., realized gains (losses) on sales of investment securities). If a component is not required to be reclassified to net income in its entirety (e.g., amortization of defined benefit plan items), entities would instead cross reference to the related note to the financial statements for additional information (e.g., pension footnote). The Company adopted the provisions of ASU No. 2013-02 effective January 1, 2013. As the provisions of ASU No. 2013-02 only amended the disclosure requirements for accumulated other comprehensive income, the adoption had no impact on the Company's consolidated statements of income and condition. See Note 6 to the Consolidated Financial Statements for the disclosures required by ASU No. 2013-02.

## Note 2. Investment Securities

The amortized cost, gross unrealized gains and losses, and fair value of the Company's investment securities as of June 30, 2013 and December 31, 2012 were as follows:

| (dollars in thousands)                                              | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value  |
|---------------------------------------------------------------------|-------------------|------------------------------|-------------------------------|-------------|
| June 30, 2013                                                       |                   |                              |                               |             |
| Available-for-Sale:                                                 |                   |                              |                               |             |
| Debt Securities Issued by the U.S. Treasury and Government Agencies | \$570,944         | \$15,125                     | \$(43 )                       | \$586,026   |
| Debt Securities Issued by States and Political Subdivisions         | 565,781           | 9,189                        | (13,050 )                     | 561,920     |
| Debt Securities Issued by Corporations                              | 280,438           | 1,336                        | (6,485 )                      | 275,289     |
| Mortgage-Backed Securities:                                         |                   |                              |                               |             |
| Residential - Government Agencies                                   | 798,266           | 17,696                       | (635 )                        | 815,327     |
| Residential - U.S. Government-Sponsored Enterprises                 | 26,872            | 1,606                        | —                             | 28,478      |
| Commercial - Government Agencies                                    | 575,246           | —                            | (26,878 )                     | 548,368     |
| Total Mortgage-Backed Securities                                    | 1,400,384         | 19,302                       | (27,513 )                     | 1,392,173   |
| Total                                                               | \$2,817,547       | \$44,952                     | \$(47,091 )                   | \$2,815,408 |
| Held-to-Maturity:                                                   |                   |                              |                               |             |
| Debt Securities Issued by the U.S. Treasury and Government Agencies | \$365,272         | \$3,832                      | \$(2,796 )                    | \$366,308   |
| Debt Securities Issued by States and Political Subdivisions         | 254,741           | 1,761                        | —                             | 256,502     |
| Debt Securities Issued by Corporations                              | 113,621           | —                            | (3,326 )                      | 110,295     |
| Mortgage-Backed Securities:                                         |                   |                              |                               |             |
| Residential - Government Agencies                                   | 3,268,222         | 37,866                       | (30,497 )                     | 3,275,591   |
| Residential - U.S. Government-Sponsored Enterprises                 | 25,973            | 1,528                        | —                             | 27,501      |
| Total Mortgage-Backed Securities                                    | 3,294,195         | 39,394                       | (30,497 )                     | 3,303,092   |
| Total                                                               | \$4,027,829       | \$44,987                     | \$(36,619 )                   | \$4,036,197 |
| December 31, 2012                                                   |                   |                              |                               |             |
| Available-for-Sale:                                                 |                   |                              |                               |             |
| Debt Securities Issued by the U.S. Treasury and Government Agencies | \$855,070         | \$14,936                     | \$(17 )                       | \$869,989   |
| Debt Securities Issued by States and Political Subdivisions         | 753,207           | 30,159                       | (955 )                        | 782,411     |
| Debt Securities Issued by Corporations                              | 82,450            | 1,984                        | —                             | 84,434      |
| Mortgage-Backed Securities:                                         |                   |                              |                               |             |
| Residential - Government Agencies                                   | 1,041,669         | 27,283                       | (292 )                        | 1,068,660   |
| Residential - U.S. Government-Sponsored Enterprises                 | 35,234            | 2,064                        | —                             | 37,298      |
| Commercial - Government Agencies                                    | 524,055           | 1,907                        | (1,197 )                      | 524,765     |
| Total Mortgage-Backed Securities                                    | 1,600,958         | 31,254                       | (1,489 )                      | 1,630,723   |
| Total                                                               | \$3,291,685       | \$78,333                     | \$(2,461 )                    | \$3,367,557 |
| Held-to-Maturity:                                                   |                   |                              |                               |             |
| Debt Securities Issued by the U.S. Treasury and Government Agencies | \$190,168         | \$5,198                      | \$—                           | \$195,366   |
| Debt Securities Issued by Corporations                              | 24,000            | 4                            | —                             | 24,004      |
| Mortgage-Backed Securities:                                         |                   |                              |                               |             |
| Residential - Government Agencies                                   | 3,349,403         | 86,673                       | (1,366 )                      | 3,434,710   |

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|                                                     |             |          |            |             |
|-----------------------------------------------------|-------------|----------|------------|-------------|
| Residential - U.S. Government-Sponsored Enterprises | 31,494      | 2,102    | —          | 33,596      |
| Total Mortgage-Backed Securities                    | 3,380,897   | 88,775   | (1,366 )   | 3,468,306   |
| Total                                               | \$3,595,065 | \$93,977 | \$(1,366 ) | \$3,687,676 |

9

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The table below presents an analysis of the contractual maturities of the Company's investment securities as of June 30, 2013. 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<br>Cost | Fair Value   |
|-----------------------------------------------------|-------------------|--------------|
| Available-for-Sale:                                 |                   |              |
| Due in One Year or Less                             | \$ 168,292        | \$ 168,666   |
| Due After One Year Through Five Years               | 256,637           | 260,614      |
| Due After Five Years Through Ten Years              | 624,515           | 614,924      |
| Due After Ten Years                                 | 367,719           | 379,031      |
|                                                     | 1,417,163         | 1,423,235    |
| Mortgage-Backed Securities:                         |                   |              |
| Residential - Government Agencies                   | 798,266           | 815,327      |
| Residential - U.S. Government-Sponsored Enterprises | 26,872            | 28,478       |
| Commercial - Government Agencies                    | 575,246           | 548,368      |
| Total Mortgage-Backed Securities                    | 1,400,384         | 1,392,173    |
| Total                                               | \$ 2,817,547      | \$ 2,815,408 |
| Held-to-Maturity:                                   |                   |              |
| Due in One Year or Less                             | \$ 70,241         | \$ 70,603    |
| Due After One Year Through Five Years               | 295,032           | 295,706      |
| Due After Five Years Through Ten Years              | 94,830            | 95,553       |
| Due After Ten Years                                 | 273,531           | 271,243      |
|                                                     | 733,634           | 733,105      |
| Mortgage-Backed Securities:                         |                   |              |
| Residential - Government Agencies                   | 3,268,222         | 3,275,591    |
| Residential - U.S. Government-Sponsored Enterprises | 25,973            | 27,501       |
| Total Mortgage-Backed Securities                    | 3,294,195         | 3,303,092    |
| Total                                               | \$ 4,027,829      | \$ 4,036,197 |

Investment securities with carrying values of \$2.7 billion and \$2.9 billion as of June 30, 2013 and December 31, 2012, respectively, were pledged to secure deposits of governmental entities and securities sold under agreements to repurchase.

There were no sales of investment securities for the three and six months ended June 30, 2013 and for the three months ended June 30, 2012. Gross realized gains on the sales of investment securities were \$0.2 million and gross realized losses on the sales of investment securities were \$0.3 million for the six months ended June 30, 2012.

The Company's investment securities in an unrealized loss position, segregated by continuous length of impairment, were as follows:

|                                                             | Less Than 12 Months |                         | 12 Months or Longer |                         | Total       |                         |
|-------------------------------------------------------------|---------------------|-------------------------|---------------------|-------------------------|-------------|-------------------------|
| (dollars in thousands)                                      | Fair Value          | Gross Unrealized Losses | Fair Value          | Gross Unrealized Losses | Fair Value  | Gross Unrealized Losses |
| June 30, 2013                                               |                     |                         |                     |                         |             |                         |
| Available-for-Sale:                                         |                     |                         |                     |                         |             |                         |
| Debt Securities Issued by the U.S.                          |                     |                         |                     |                         |             |                         |
| Treasury and Government Agencies                            | \$2,706             | \$(40 )                 | \$429               | \$(3 )                  | \$3,135     | \$(43 )                 |
| Debt Securities Issued by States and Political Subdivisions | 352,120             | (13,050 )               | —                   | —                       | 352,120     | (13,050 )               |
| Debt Securities Issued by Corporations                      | 201,741             | (6,485 )                | —                   | —                       | 201,741     | (6,485 )                |
| Mortgage-Backed Securities:                                 |                     |                         |                     |                         |             |                         |
| Residential - Government Agencies                           | 46,355              | (179 )                  | 12,288              | (456 )                  | 58,643      | (635 )                  |
| Commercial - Government Agencies                            | 548,367             | (26,878 )               | —                   | —                       | 548,367     | (26,878 )               |
| Total Mortgage-Backed Securities                            | 594,722             | (27,057 )               | 12,288              | (456 )                  | 607,010     | (27,513 )               |
| Total                                                       | \$1,151,289         | \$(46,632 )             | \$12,717            | \$(459 )                | \$1,164,006 | \$(47,091 )             |
| Held-to-Maturity:                                           |                     |                         |                     |                         |             |                         |
| Debt Securities Issued by the U.S.                          |                     |                         |                     |                         |             |                         |
| Treasury and Government Agencies                            | \$183,046           | \$(2,796 )              | \$—                 | \$—                     | \$183,046   | \$(2,796 )              |
| Debt Securities Issued by Corporations                      | 88,295              | (3,326 )                | —                   | —                       | 88,295      | (3,326 )                |
| Mortgage-Backed Securities:                                 |                     |                         |                     |                         |             |                         |
| Residential - Government Agencies                           | 1,513,576           | (30,497 )               | —                   | —                       | 1,513,576   | (30,497 )               |
| Total                                                       | \$1,784,917         | \$(36,619 )             | \$—                 | \$—                     | \$1,784,917 | \$(36,619 )             |
| December 31, 2012                                           |                     |                         |                     |                         |             |                         |
| Available-for-Sale:                                         |                     |                         |                     |                         |             |                         |
| Debt Securities Issued by the U.S.                          |                     |                         |                     |                         |             |                         |
| Treasury and Government Agencies                            | \$2,295             | \$(14 )                 | \$564               | \$(3 )                  | \$2,859     | \$(17 )                 |
| Debt Securities Issued by States and Political Subdivisions | 72,400              | (955 )                  | —                   | —                       | 72,400      | (955 )                  |
| Mortgage-Backed Securities:                                 |                     |                         |                     |                         |             |                         |
| Residential - Government Agencies                           | 7,325               | (57 )                   | 22,389              | (235 )                  | 29,714      | (292 )                  |
| Commercial - Government Agencies                            | 261,883             | (1,197 )                | —                   | —                       | 261,883     | (1,197 )                |
| Total Mortgage-Backed Securities                            | 269,208             | (1,254 )                | 22,389              | (235 )                  | 291,597     | (1,489 )                |
| Total                                                       | \$343,903           | \$(2,223 )              | \$22,953            | \$(238 )                | \$366,856   | \$(2,461 )              |
| Held-to-Maturity:                                           |                     |                         |                     |                         |             |                         |
| Mortgage-Backed Securities:                                 |                     |                         |                     |                         |             |                         |
| Residential - Government Agencies                           | \$351,762           | \$(1,366 )              | \$—                 | \$—                     | \$351,762   | \$(1,366 )              |
| Total                                                       | \$351,762           | \$(1,366 )              | \$—                 | \$—                     | \$351,762   | \$(1,366 )              |

The Company does not believe that the investment securities that were in an unrealized loss position as of June 30, 2013, which was comprised of 247 securities, represent an other-than-temporary impairment. Total gross unrealized losses were primarily 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. As of June 30, 2013 and December 31, 2012, the gross unrealized losses reported for mortgage-backed securities were related to investment securities issued by the Government National Mortgage Association. The Company does not intend to sell the investment securities that were in an unrealized loss position and it is not more likely than not that the Company will be required to sell the investment securities before recovery of their amortized cost bases, which may be at maturity.

As of June 30, 2013, included in the Company's investment securities at fair value were securities issued by political subdivisions within the State of Hawaii of \$569.9 million, representing 70% of the total fair value of the Company's municipal debt securities. Of the entire Hawaii municipal bond portfolio, 94% were credit-rated Aa2 or better by Moody's while the remaining Hawaii municipal bonds were credit-rated A2 or better by at least one nationally recognized statistical rating organization. Also, approximately 76% of the Company's Hawaii municipal bond holdings were general obligation issuances. As of June 30, 2013, there were no other holdings of municipal debt securities that were issued by a single state or political subdivision which comprised more than 5% of the total fair value of the Company's municipal debt securities.

As of June 30, 2013, the carrying value of the Company's Federal Home Loan Bank and Federal Reserve Bank stock was as follows:

| (dollars in thousands)       | June 30,<br>2013 | December 31,<br>2012 |
|------------------------------|------------------|----------------------|
| Federal Home Loan Bank Stock | \$59,109         | \$ 60,200            |
| Federal Reserve Bank Stock   | 19,055           | 18,952               |
| Total                        | \$78,164         | \$ 79,152            |

These securities can only be redeemed or sold at their par value and only to the respective issuing government-supported institution or to another member institution. The Company records these non-marketable equity securities as a component of other assets and periodically evaluates these securities for impairment. Management considers these non-marketable equity securities to be long-term investments. Accordingly, when evaluating these securities for impairment, management considers the ultimate recoverability of the par value rather than by recognizing temporary declines in value.

### Note 3. Loans and Leases and the Allowance for Loan and Lease Losses

#### Loans and Leases

The Company's loan and lease portfolio was comprised of the following as of June 30, 2013 and December 31, 2012:

| (dollars in thousands)    | June 30,<br>2013 | December 31,<br>2012 |
|---------------------------|------------------|----------------------|
| Commercial                |                  |                      |
| Commercial and Industrial | \$875,702        | \$829,512            |
| Commercial Mortgage       | 1,160,977        | 1,097,425            |
| Construction              | 107,016          | 113,987              |
| Lease Financing           | 257,067          | 274,969              |
| Total Commercial          | 2,400,762        | 2,315,893            |
| Consumer                  |                  |                      |
| Residential Mortgage      | 2,252,117        | 2,349,916            |
| Home Equity               | 751,790          | 770,376              |
| Automobile                | 233,475          | 209,832              |
| Other <sup>1</sup>        | 221,008          | 208,504              |
| Total Consumer            | 3,458,390        | 3,538,628            |
| Total Loans and Leases    | \$5,859,152      | \$5,854,521          |

<sup>1</sup> Comprised of other revolving credit, installment, and lease financing.

Most of the Company's lending activity is with customers located in the State of Hawaii. A substantial portion of the Company's real estate loans are secured by real estate in Hawaii.

Net gains related to sales of residential mortgage loans, recorded as a component of mortgage banking income, were \$4.8 million and \$2.3 million for the three months ended June 30, 2013 and 2012, respectively, and \$12.4 million and \$4.7 million for the six months ended June 30, 2013 and 2012, respectively.

# Allowance for Loan and Lease Losses (the “Allowance”)

The following presents by portfolio segment, the activity in the Allowance for the three and six months ended June 30, 2013 and 2012. The following also presents by portfolio segment, the balance in the Allowance disaggregated on the basis of the Company’s impairment measurement method and the related recorded investment in loans and leases as of June 30, 2013 and 2012.

| (dollars in thousands)                                | Commercial  | Consumer    | Total       |
|-------------------------------------------------------|-------------|-------------|-------------|
| Three Months Ended June 30, 2013                      |             |             |             |
| Allowance for Loan and Lease Losses:                  |             |             |             |
| Balance at Beginning of Period                        | \$73,416    | \$53,462    | \$126,878   |
| Loans and Leases Charged-Off                          | (266 )      | (4,438 )    | (4,704 )    |
| Recoveries on Loans and Leases Previously Charged-Off | 470         | 1,931       | 2,401       |
| Net Loans and Leases Charged-Off                      | 204         | (2,507 )    | (2,303 )    |
| Provision for Credit Losses                           | (3,423 )    | 3,423       | —           |
| Balance at End of Period                              | \$70,197    | \$54,378    | \$124,575   |
| Six Months Ended June 30, 2013                        |             |             |             |
| Allowance for Loan and Lease Losses:                  |             |             |             |
| Balance at Beginning of Period                        | \$72,704    | \$56,153    | \$128,857   |
| Loans and Leases Charged-Off                          | (648 )      | (9,355 )    | (10,003 )   |
| Recoveries on Loans and Leases Previously Charged-Off | 1,267       | 4,454       | 5,721       |
| Net Loans and Leases Charged-Off                      | 619         | (4,901 )    | (4,282 )    |
| Provision for Credit Losses                           | (3,126 )    | 3,126       | —           |
| Balance at End of Period                              | \$70,197    | \$54,378    | \$124,575   |
| As of June 30, 2013                                   |             |             |             |
| Allowance for Loan and Lease Losses:                  |             |             |             |
| Individually Evaluated for Impairment                 | \$195       | \$3,927     | \$4,122     |
| Collectively Evaluated for Impairment                 | 70,002      | 50,451      | 120,453     |
| Total                                                 | \$70,197    | \$54,378    | \$124,575   |
| Recorded Investment in Loans and Leases:              |             |             |             |
| Individually Evaluated for Impairment                 | \$20,059    | \$36,756    | \$56,815    |
| Collectively Evaluated for Impairment                 | 2,380,703   | 3,421,634   | 5,802,337   |
| Total                                                 | \$2,400,762 | \$3,458,390 | \$5,859,152 |
| Three Months Ended June 30, 2012                      |             |             |             |
| Allowance for Loan and Lease Losses:                  |             |             |             |
| Balance at Beginning of Period                        | \$78,174    | \$57,432    | \$135,606   |
| Loans and Leases Charged-Off                          | (1,078 )    | (4,858 )    | (5,936 )    |
| Recoveries on Loans and Leases Previously Charged-Off | 545         | 1,600       | 2,145       |
| Net Loans and Leases Charged-Off                      | (533 )      | (3,258 )    | (3,791 )    |
| Provision for Credit Losses                           | 371         | 257         | 628         |
| Balance at End of Period                              | \$78,012    | \$54,431    | \$132,443   |
| Six Months Ended June 30, 2012                        |             |             |             |
| Allowance for Loan and Lease Losses:                  |             |             |             |
| Balance at Beginning of Period                        | \$80,562    | \$58,044    | \$138,606   |
| Loans and Leases Charged-Off                          | (2,839 )    | (10,856 )   | (13,695 )   |
| Recoveries on Loans and Leases Previously Charged-Off | 2,574       | 3,979       | 6,553       |
| Net Loans and Leases Charged-Off                      | (265 )      | (6,877 )    | (7,142 )    |
| Provision for Credit Losses                           | (2,285 )    | 3,264       | 979         |

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|                                                 |             |             |             |
|-------------------------------------------------|-------------|-------------|-------------|
| Balance at End of Period<br>As of June 30, 2012 | \$78,012    | \$54,431    | \$132,443   |
| Allowance for Loan and Lease Losses:            |             |             |             |
| Individually Evaluated for Impairment           | \$54        | \$4,774     | \$4,828     |
| Collectively Evaluated for Impairment           | 77,958      | 49,657      | 127,615     |
| Total                                           | \$78,012    | \$54,431    | \$132,443   |
| Recorded Investment in Loans and Leases:        |             |             |             |
| Individually Evaluated for Impairment           | \$14,131    | \$32,687    | \$46,818    |
| Collectively Evaluated for Impairment           | 2,108,229   | 3,516,436   | 5,624,665   |
| Total                                           | \$2,122,360 | \$3,549,123 | \$5,671,483 |

## Credit Quality Indicators

The Company uses several credit quality indicators to manage credit risk in an ongoing manner. The Company uses an internal credit risk rating system that categorizes loans and leases into pass, special mention, or classified categories. Credit risk ratings are applied individually to those classes of loans and leases that have significant or unique credit characteristics that benefit from a case-by-case evaluation. These are typically loans and leases to businesses or individuals in the classes which comprise the commercial portfolio segment. Groups of loans and leases that are underwritten and structured using standardized criteria and characteristics, such as statistical models (e.g., credit scoring or payment performance), are typically risk-rated and monitored collectively. These are typically loans and leases to individuals in the classes which comprise the consumer portfolio segment.

The following are the definitions of the Company's credit quality indicators:

**Pass:** Loans and leases in all classes within the commercial and consumer portfolio segments that are not adversely rated. Management believes that there is a low likelihood of loss related to those loans and leases that are considered pass.

**Special Mention:** Loans and leases in the classes within the commercial portfolio segment that have potential weaknesses that deserve management's close attention. If not addressed, these potential weaknesses may result in deterioration of the repayment prospects for the loan or lease. The special mention credit quality indicator is not used for classes of loans and leases that are included in the consumer portfolio segment. Management believes that there is a moderate likelihood of some loss related to those loans and leases that are considered special mention.

**Classified:** Loans and leases in the classes within the commercial portfolio segment that are inadequately protected by the sound worth and paying capacity of the borrower or of the collateral pledged, if any. Classified loans and leases are also those in the classes within the consumer portfolio segment that are past due 90 days or more as to principal or interest. Residential mortgage loans that are past due 90 days or more as to principal or interest may be considered pass if the Company is in the process of collection and the current loan-to-value ratio is 60% or less. Home equity loans that are past due 90 days or more as to principal or interest may be considered pass if the Company is in the process of collection, the first mortgage is with the Company, and the current combined loan-to-value ratio is 60% or less. Residential mortgage and home equity loans may be current as to principal and interest, but may be considered classified for a period of up to six months following a loan modification. Following a period of demonstrated performance in accordance with the modified contractual terms, the loan may be removed from classified status. Management believes that there is a distinct possibility that the Company will sustain some loss if the deficiencies related to classified loans and leases are not corrected in a timely manner.

The Company's credit quality indicators are periodically updated on a case-by-case basis. The following presents by class and by credit quality indicator, the recorded investment in the Company's loans and leases as of June 30, 2013 and December 31, 2012.

|                                               | June 30, 2013                |                        |              |                    |                     |
|-----------------------------------------------|------------------------------|------------------------|--------------|--------------------|---------------------|
| (dollars in thousands)                        | Commercial<br>and Industrial | Commercial<br>Mortgage | Construction | Lease<br>Financing | Total<br>Commercial |
| Pass                                          | \$822,965                    | \$1,086,806            | \$90,439     | \$230,545          | \$2,230,755         |
| Special Mention                               | 9,736                        | 25,044                 | 13,542       | 25,696             | 74,018              |
| Classified                                    | 43,001                       | 49,127                 | 3,035        | 826                | 95,989              |
| Total                                         | \$875,702                    | \$1,160,977            | \$107,016    | \$257,067          | \$2,400,762         |
|                                               |                              |                        |              |                    |                     |
| (dollars in thousands)                        | Residential<br>Mortgage      | Home<br>Equity         | Automobile   | Other <sup>1</sup> | Total<br>Consumer   |
| Pass                                          | \$2,228,382                  | \$747,318              | \$233,380    | \$220,153          | \$3,429,233         |
| Classified                                    | 23,735                       | 4,472                  | 95           | 855                | 29,157              |
| Total                                         | \$2,252,117                  | \$751,790              | \$233,475    | \$221,008          | \$3,458,390         |
| Total Recorded Investment in Loans and Leases |                              |                        |              |                    | \$5,859,152         |
|                                               |                              |                        |              |                    |                     |
|                                               | December 31, 2012            |                        |              |                    |                     |
| (dollars in thousands)                        | Commercial<br>and Industrial | Commercial<br>Mortgage | Construction | Lease<br>Financing | Total<br>Commercial |
| Pass                                          | \$779,654                    | \$1,018,128            | \$96,058     | \$247,401          | \$2,141,241         |
| Special Mention                               | 22,759                       | 23,848                 | 15,839       | 26,540             | 88,986              |
| Classified                                    | 27,099                       | 55,449                 | 2,090        | 1,028              | 85,666              |
| Total                                         | \$829,512                    | \$1,097,425            | \$113,987    | \$274,969          | \$2,315,893         |
|                                               |                              |                        |              |                    |                     |
| (dollars in thousands)                        | Residential<br>Mortgage      | Home<br>Equity         | Automobile   | Other <sup>1</sup> | Total<br>Consumer   |
| Pass                                          | \$2,326,216                  | \$766,912              | \$209,646    | \$207,917          | \$3,510,691         |
| Classified                                    | 23,700                       | 3,464                  | 186          | 587                | 27,937              |
| Total                                         | \$2,349,916                  | \$770,376              | \$209,832    | \$208,504          | \$3,538,628         |
| Total Recorded Investment in Loans and Leases |                              |                        |              |                    | \$5,854,521         |

<sup>1</sup> Comprised of other revolving credit, installment, and lease financing.

## Aging Analysis

The following presents by class, an aging analysis of the Company's loan and lease portfolio as of June 30, 2013 and December 31, 2012.

| (dollars in thousands)    | 30 - 59<br>Days<br>Past<br>Due | 60 - 89<br>Days<br>Past<br>Due | Past<br>Due<br>90 Days<br>or More | Non-<br>Accrual | Total<br>Past Due<br>and<br>Non-Accrual | Current     | Total<br>Loans and<br>Leases | Non-Accrual<br>Loans and<br>Leases that<br>are<br>Current <sup>2</sup> |
|---------------------------|--------------------------------|--------------------------------|-----------------------------------|-----------------|-----------------------------------------|-------------|------------------------------|------------------------------------------------------------------------|
| As of June 30, 2013       |                                |                                |                                   |                 |                                         |             |                              |                                                                        |
| Commercial                |                                |                                |                                   |                 |                                         |             |                              |                                                                        |
| Commercial and Industrial | \$467                          | \$1,255                        | \$—                               | \$4,909         | \$6,631                                 | \$869,071   | \$875,702                    | \$4,332                                                                |
| Commercial Mortgage       | 422                            | 742                            | —                                 | 2,772           | 3,936                                   | 1,157,041   | 1,160,977                    | 1,938                                                                  |
| Construction              | —                              | —                              | —                                 | —               | —                                       | 107,016     | 107,016                      | —                                                                      |
| Lease Financing           | —                              | —                              | —                                 | 16              | 16                                      | 257,051     | 257,067                      | —                                                                      |
| Total Commercial          | 889                            | 1,997                          | —                                 | 7,697           | 10,583                                  | 2,390,179   | 2,400,762                    | 6,270                                                                  |
| Consumer                  |                                |                                |                                   |                 |                                         |             |                              |                                                                        |
| Residential Mortgage      | 8,191                          | 3,134                          | 6,875                             | 22,876          | 41,076                                  | 2,211,041   | 2,252,117                    | 4,002                                                                  |
| Home Equity               | 4,533                          | 4,285                          | 2,768                             | 2,602           | 14,188                                  | 737,602     | 751,790                      | 736                                                                    |
| Automobile                | 3,313                          | 355                            | 95                                | —               | 3,763                                   | 229,712     | 233,475                      | —                                                                      |
| Other <sup>1</sup>        | 2,243                          | 1,296                          | 855                               | —               | 4,394                                   | 216,614     | 221,008                      | —                                                                      |
| Total Consumer            | 18,280                         | 9,070                          | 10,593                            | 25,478          | 63,421                                  | 3,394,969   | 3,458,390                    | 4,738                                                                  |
| Total                     | \$19,169                       | \$11,067                       | \$10,593                          | \$33,175        | \$74,004                                | \$5,785,148 | \$5,859,152                  | \$11,008                                                               |
| As of December 31, 2012   |                                |                                |                                   |                 |                                         |             |                              |                                                                        |
| Commercial                |                                |                                |                                   |                 |                                         |             |                              |                                                                        |
| Commercial and Industrial | \$806                          | \$10,382                       | \$27                              | \$5,534         | \$16,749                                | \$812,763   | \$829,512                    | \$4,963                                                                |
| Commercial Mortgage       | 188                            | 542                            | —                                 | 3,030           | 3,760                                   | 1,093,665   | 1,097,425                    | 1,810                                                                  |
| Construction              | —                              | —                              | —                                 | 833             | 833                                     | 113,154     | 113,987                      | 833                                                                    |
| Lease Financing           | —                              | —                              | —                                 | —               | —                                       | 274,969     | 274,969                      | —                                                                      |
| Total Commercial          | 994                            | 10,924                         | 27                                | 9,397           | 21,342                                  | 2,294,551   | 2,315,893                    | 7,606                                                                  |
| Consumer                  |                                |                                |                                   |                 |                                         |             |                              |                                                                        |
| Residential Mortgage      | 6,891                          | 5,433                          | 6,908                             | 21,725          | 40,957                                  | 2,308,959   | 2,349,916                    | 4,941                                                                  |
| Home Equity               | 6,768                          | 3,267                          | 2,701                             | 2,074           | 14,810                                  | 755,566     | 770,376                      | 191                                                                    |
| Automobile                | 3,758                          | 586                            | 186                               | —               | 4,530                                   | 205,302     | 209,832                      | —                                                                      |
| Other <sup>1</sup>        | 2,144                          | 1,093                          | 587                               | —               | 3,824                                   | 204,680     | 208,504                      | —                                                                      |
| Total Consumer            | 19,561                         | 10,379                         | 10,382                            | 23,799          | 64,121                                  | 3,474,507   | 3,538,628                    | 5,132                                                                  |
| Total                     | \$20,555                       | \$21,303                       | \$10,409                          | \$33,196        | \$85,463                                | \$5,769,058 | \$5,854,521                  | \$12,738                                                               |

<sup>1</sup> Comprised of other revolving credit, installment, and lease financing.

<sup>2</sup> Represents non-accrual loans that are not past due 30 days or more; however, full payment of principal and interest is still not expected.



## Impaired Loans

The following presents by class, information related to impaired loans as of June 30, 2013 and December 31, 2012.

| (dollars in thousands)                                  | Recorded<br>Investment | Unpaid<br>Principal<br>Balance | Related<br>Allowance<br>for<br>Loan Losses |
|---------------------------------------------------------|------------------------|--------------------------------|--------------------------------------------|
| June 30, 2013                                           |                        |                                |                                            |
| Impaired Loans with No Related Allowance Recorded:      |                        |                                |                                            |
| Commercial                                              |                        |                                |                                            |
| Commercial and Industrial                               | \$9,166                | \$14,415                       | \$—                                        |
| Commercial Mortgage                                     | 8,318                  | 8,818                          | —                                          |
| Total Commercial                                        | 17,484                 | 23,233                         | —                                          |
| Total Impaired Loans with No Related Allowance Recorded | \$17,484               | \$23,233                       | \$—                                        |
| Impaired Loans with an Allowance Recorded:              |                        |                                |                                            |
| Commercial                                              |                        |                                |                                            |
| Commercial and Industrial                               | \$2,528                | \$2,528                        | \$184                                      |
| Commercial Mortgage                                     | 47                     | 47                             | 11                                         |
| Total Commercial                                        | 2,575                  | 2,575                          | 195                                        |
| Consumer                                                |                        |                                |                                            |
| Residential Mortgage                                    | 31,327                 | 37,580                         | 3,846                                      |
| Automobile                                              | 5,151                  | 5,151                          | 69                                         |
| Other <sup>1</sup>                                      | 278                    | 278                            | 12                                         |
| Total Consumer                                          | 36,756                 | 43,009                         | 3,927                                      |
| Total Impaired Loans with an Allowance Recorded         | \$39,331               | \$45,584                       | \$4,122                                    |
| Impaired Loans:                                         |                        |                                |                                            |
| Commercial                                              | \$20,059               | \$25,808                       | \$195                                      |
| Consumer                                                | 36,756                 | 43,009                         | 3,927                                      |
| Total Impaired Loans                                    | \$56,815               | \$68,817                       | \$4,122                                    |
| December 31, 2012                                       |                        |                                |                                            |
| Impaired Loans with No Related Allowance Recorded:      |                        |                                |                                            |
| Commercial                                              |                        |                                |                                            |
| Commercial and Industrial                               | \$7,464                | \$12,714                       | \$—                                        |
| Commercial Mortgage                                     | 2,971                  | 3,471                          | —                                          |
| Construction                                            | 833                    | 1,163                          | —                                          |
| Total Commercial                                        | 11,268                 | 17,348                         | —                                          |
| Total Impaired Loans with No Related Allowance Recorded | \$11,268               | \$17,348                       | \$—                                        |
| Impaired Loans with an Allowance Recorded:              |                        |                                |                                            |
| Commercial                                              |                        |                                |                                            |
| Commercial and Industrial                               | \$1,772                | \$1,772                        | \$148                                      |
| Commercial Mortgage                                     | 58                     | 58                             | 13                                         |
| Total Commercial                                        | 1,830                  | 1,830                          | 161                                        |
| Consumer                                                |                        |                                |                                            |
| Residential Mortgage                                    | 31,577                 | 38,219                         | 3,492                                      |
| Automobile                                              | 5,641                  | 5,641                          | 58                                         |

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|                                                                             |          |          |         |
|-----------------------------------------------------------------------------|----------|----------|---------|
| Other <sup>1</sup>                                                          | 282      | 282      | 14      |
| Total Consumer                                                              | 37,500   | 44,142   | 3,564   |
| Total Impaired Loans with an Allowance Recorded                             | \$39,330 | \$45,972 | \$3,725 |
| Impaired Loans:                                                             |          |          |         |
| Commercial                                                                  | \$13,098 | \$19,178 | \$161   |
| Consumer                                                                    | 37,500   | 44,142   | 3,564   |
| Total Impaired Loans                                                        | \$50,598 | \$63,320 | \$3,725 |
| <sup>1</sup> Comprised of other revolving credit and installment financing. |          |          |         |

The following presents by class, information related to the average recorded investment and interest income recognized on impaired loans for the three and six months ended June 30, 2013 and 2012.

| (dollars in thousands)                                  | Three Months Ended<br>June 30, 2013 |                               | Three Months Ended<br>June 30, 2012 |                               |
|---------------------------------------------------------|-------------------------------------|-------------------------------|-------------------------------------|-------------------------------|
|                                                         | Average Recorded<br>Investment      | Interest Income<br>Recognized | Average Recorded<br>Investment      | Interest Income<br>Recognized |
| Impaired Loans with No Related Allowance Recorded:      |                                     |                               |                                     |                               |
| Commercial                                              |                                     |                               |                                     |                               |
| Commercial and Industrial                               | \$8,067                             | \$ —                          | \$9,093                             | \$ —                          |
| Commercial Mortgage                                     | 6,085                               | —                             | 2,571                               | —                             |
| Construction                                            | —                                   | —                             | 1,332                               | —                             |
| Total Commercial                                        | 14,152                              | —                             | 12,996                              | —                             |
| Total Impaired Loans with No Related Allowance Recorded | \$14,152                            | \$ —                          | \$12,996                            | \$ —                          |
| Impaired Loans with an Allowance Recorded:              |                                     |                               |                                     |                               |
| Commercial                                              |                                     |                               |                                     |                               |
| Commercial and Industrial                               | \$2,386                             | \$ 72                         | \$918                               | \$ 31                         |
| Commercial Mortgage                                     | 50                                  | 43                            | 146                                 | 4                             |
| Total Commercial                                        | 2,436                               | 115                           | 1,064                               | 35                            |
| Consumer                                                |                                     |                               |                                     |                               |
| Residential Mortgage                                    | 31,112                              | 173                           | 25,133                              | 77                            |
| Automobile                                              | 5,223                               | 125                           | 5,803                               | 149                           |
| Other <sup>1</sup>                                      | 278                                 | 3                             | 402                                 | 3                             |
| Total Consumer                                          | 36,613                              | 301                           | 31,338                              | 229                           |
| Total Impaired Loans with an Allowance Recorded         | \$39,049                            | \$ 416                        | \$32,402                            | \$ 264                        |
| Impaired Loans:                                         |                                     |                               |                                     |                               |
| Commercial                                              | \$16,588                            | \$ 115                        | \$14,060                            | \$ 35                         |
| Consumer                                                | 36,613                              | 301                           | 31,338                              | 229                           |
| Total Impaired Loans                                    | \$53,201                            | \$ 416                        | \$45,398                            | \$ 264                        |
| (dollars in thousands)                                  | Six Months Ended<br>June 30, 2013   |                               | Six Months Ended<br>June 30, 2012   |                               |
|                                                         | Average Recorded<br>Investment      | Interest Income<br>Recognized | Average Recorded<br>Investment      | Interest Income<br>Recognized |
| Impaired Loans with No Related Allowance Recorded:      |                                     |                               |                                     |                               |
| Commercial                                              |                                     |                               |                                     |                               |
| Commercial and Industrial                               | \$7,866                             | \$ —                          | \$8,121                             | \$ —                          |
| Commercial Mortgage                                     | 5,047                               | —                             | 2,427                               | —                             |
| Construction                                            | 278                                 | —                             | 888                                 | —                             |
| Total Commercial                                        | 13,191                              | —                             | 11,436                              | —                             |
| Total Impaired Loans with No Related Allowance Recorded | \$13,191                            | \$ —                          | \$11,436                            | \$ —                          |
| Impaired Loans with an Allowance Recorded:              |                                     |                               |                                     |                               |
| Commercial                                              |                                     |                               |                                     |                               |
| Commercial and Industrial                               | \$2,181                             | \$ 122                        | \$2,094                             | \$ 64                         |

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|                                        |          |        |          |        |
|----------------------------------------|----------|--------|----------|--------|
| Commercial Mortgage                    | 53       | 51     | 195      | 8      |
| Construction                           | —        | —      | 693      | —      |
| Total Commercial                       | 2,234    | 173    | 2,982    | 72     |
| Consumer                               |          |        |          |        |
| Residential Mortgage                   | 31,267   | 320    | 25,330   | 157    |
| Home Equity                            | —        | —      | 7        | —      |
| Automobile                             | 5,362    | 258    | 5,932    | 303    |
| Other <sup>1</sup>                     | 279      | 6      | 444      | 10     |
| Total Consumer                         | 36,908   | 584    | 31,713   | 470    |
| Total Impaired Loans with an Allowance |          |        |          |        |
| Recorded                               | \$39,142 | \$ 757 | \$34,695 | \$ 542 |
| Impaired Loans:                        |          |        |          |        |
| Commercial                             | \$15,425 | \$ 173 | \$14,418 | \$ 72  |
| Consumer                               | 36,908   | 584    | 31,713   | 470    |
| Total Impaired Loans                   | \$52,333 | \$ 757 | \$46,131 | \$ 542 |

<sup>1</sup> Comprised of other revolving credit and installment financing.

For the three and six months ended June 30, 2013 and 2012, the amount of interest income recognized by the Company within the periods that the loans were impaired were primarily related to loans modified in a troubled debt restructuring that remained on accrual status. For the three and six months ended June 30, 2013 and 2012, the amount of interest income recognized using a cash-basis method of accounting during the periods that the loans were impaired was not material.

#### Modifications

A modification of a loan constitutes a troubled debt restructuring (“TDR”) when the Company for economic or legal reasons related to a borrower’s financial difficulties grants a concession to the borrower that it would not otherwise consider. Loans modified in a TDR were \$50.7 million and \$41.1 million as of June 30, 2013 and December 31, 2012, respectively. There were no commitments to lend additional funds on loans modified in a TDR as of June 30, 2013.

The Company offers various types of concessions when modifying a loan or lease, however, forgiveness of principal is rarely granted. Commercial and industrial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested. Commercial mortgage and construction loans modified in a TDR often 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. Construction loans modified in a TDR may also involve extending the interest-only payment period. Lease financing modifications generally involve a short-term forbearance period, usually about three months, after which the missed payments are added to the end of the lease term, thereby extending the maturity date. Interest continues to accrue on the missed payments and as a result, the effective yield on the lease 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. Prior to November 2012, residential mortgage loans modified in a TDR were primarily comprised of loans where monthly payments were lowered to accommodate the borrowers' financial needs for a period of time, normally two years. During that time, the borrower's entire monthly payment was applied to principal. After the lowered monthly payment period ended, the borrower reverted back to paying principal and interest per the original terms with the maturity date adjusted accordingly. Effective November 2012, the Company revised its modification program to resemble the Federal Government's Home Affordable Modification Payment (“HAMP”) Tier 2 program. Under this modification program, the concessions generally include a lower interest rate and the loan being fully amortized for up to 40 years from the modification effective date. In some cases, the Company may forbear a portion of the unpaid principal balance with a balloon payment due upon maturity or pay-off of the loan. Land loans are also included in the class of residential mortgage loans. Land loans are typically structured as interest-only monthly payments with a balloon payment due at maturity. Prior to September 2012, land loans modified in a TDR typically involved extending the balloon payment by one to three years, changing the monthly payments from interest-only to principal and interest, while leaving the interest rate unchanged. In September 2012, the land loan modification program was changed to offer an extension to term-out and fully amortize the loan over a period of up to 360 months. Home equity modifications are made infrequently and are offered to borrowers if the Company does not hold the first mortgage. Home equity modifications are uniquely designed to meet the specific needs of each borrower. Borrowers having both a first mortgage and home equity loan with the Company are offered a residential mortgage loan modification. Automobile loans modified in a TDR are primarily comprised of loans where the Company has lowered monthly payments by extending the term.

Loans modified in a TDR are typically already on non-accrual status and partial charge-offs have in some cases already been taken against the outstanding loan balance. As a result, loans modified in a TDR may have the financial effect of increasing the specific Allowance associated with the loan. An Allowance for impaired consumer and

commercial 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. 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, 2013 and 2012.

| Troubled Debt Restructurings<br>(dollars in thousands) | Loans Modified as a TDR for the<br>Three Months Ended June 30, 2013 |                                              |                                                | Loans Modified as a TDR for the<br>Three Months Ended June 30, 2012 |                                              |                                                |
|--------------------------------------------------------|---------------------------------------------------------------------|----------------------------------------------|------------------------------------------------|---------------------------------------------------------------------|----------------------------------------------|------------------------------------------------|
|                                                        | Number of<br>Contracts                                              | Recorded<br>Investment<br>(as of period end) | Increase in<br>Allowance<br>(as of period end) | Number of<br>Contracts                                              | Recorded<br>Investment<br>(as of period end) | Increase in<br>Allowance<br>(as of period end) |
| Commercial                                             |                                                                     |                                              |                                                |                                                                     |                                              |                                                |
| Commercial and Industrial                              | 18                                                                  | \$ 3,580                                     | \$ 122                                         | 1                                                                   | \$ 45                                        | \$ 3                                           |
| Commercial Mortgage                                    | 4                                                                   | 4,617                                        | —                                              | —                                                                   | —                                            | —                                              |
| Construction                                           | —                                                                   | —                                            | —                                              | 1                                                                   | 1,182                                        | —                                              |
| Total Commercial                                       | 22                                                                  | 8,197                                        | 122                                            | 2                                                                   | 1,227                                        | 3                                              |
| Consumer                                               |                                                                     |                                              |                                                |                                                                     |                                              |                                                |
| Residential Mortgage                                   | 9                                                                   | 3,092                                        | 865                                            | 5                                                                   | 4,367                                        | 826                                            |
| Automobile                                             | 43                                                                  | 549                                          | 7                                              | 48                                                                  | 516                                          | 4                                              |
| Other <sup>2</sup>                                     | 1                                                                   | 3                                            | —                                              | —                                                                   | —                                            | —                                              |
| Total Consumer                                         | 53                                                                  | 3,644                                        | 872                                            | 53                                                                  | 4,883                                        | 830                                            |
| Total                                                  | 75                                                                  | \$ 11,841                                    | \$ 994                                         | 55                                                                  | \$ 6,110                                     | \$ 833                                         |

| Troubled Debt Restructurings<br>(dollars in thousands) | Loans Modified as a TDR for the<br>Six Months Ended June 30, 2013 |                                              |                                                | Loans Modified as a TDR for the<br>Six Months Ended June 30, 2012 |                                              |                                                |
|--------------------------------------------------------|-------------------------------------------------------------------|----------------------------------------------|------------------------------------------------|-------------------------------------------------------------------|----------------------------------------------|------------------------------------------------|
|                                                        | Number of<br>Contracts                                            | Recorded<br>Investment<br>(as of period end) | Increase in<br>Allowance<br>(as of period end) | Number of<br>Contracts                                            | Recorded<br>Investment<br>(as of period end) | Increase in<br>Allowance<br>(as of period end) |
| Commercial                                             |                                                                   |                                              |                                                |                                                                   |                                              |                                                |
| Commercial and Industrial                              | 22                                                                | \$ 3,620                                     | \$ 123                                         | 1                                                                 | \$ 45                                        | \$ 3                                           |
| Commercial Mortgage                                    | 5                                                                 | 5,593                                        | —                                              | —                                                                 | —                                            | —                                              |
| Construction                                           | —                                                                 | —                                            | —                                              | 1                                                                 | 1,182                                        | —                                              |
| Total Commercial                                       | 27                                                                | 9,213                                        | 123                                            | 2                                                                 | 1,227                                        | 3                                              |
| Consumer                                               |                                                                   |                                              |                                                |                                                                   |                                              |                                                |
| Residential Mortgage                                   | 11                                                                | 4,068                                        | 1,050                                          | 5                                                                 | 4,367                                        | 826                                            |
| Automobile                                             | 82                                                                | 980                                          | 13                                             | 88                                                                | 934                                          | 8                                              |
| Other <sup>2</sup>                                     | 1                                                                 | 3                                            | —                                              | —                                                                 | —                                            | —                                              |
| Total Consumer                                         | 94                                                                | 5,051                                        | 1,063                                          | 93                                                                | 5,301                                        | 834                                            |
| Total                                                  | 121                                                               | \$ 14,264                                    | \$ 1,186                                       | 95                                                                | \$ 6,528                                     | \$ 837                                         |

<sup>1</sup> The period end balances reflect all paydowns and charge-offs since the modification date. TDRs fully paid-off, charged-off, or foreclosed upon by period end are not included.

<sup>2</sup> Comprised of other revolving credit and installment financing.

The following presents by class, all loans modified in a TDR that defaulted during the three and six months ended June 30, 2013 and 2012, and within twelve months of their modification date. A TDR is considered to be in default once it becomes 60 days or more past due following a modification.

| TDRs that Defaulted During the Period,<br>Within Twelve Months of their Modification Date<br>(dollars in thousands) | Three Months Ended<br>June 30, 2013 |                                                           | Three Months Ended<br>June 30, 2012 |                                               |
|---------------------------------------------------------------------------------------------------------------------|-------------------------------------|-----------------------------------------------------------|-------------------------------------|-----------------------------------------------|
|                                                                                                                     | Number of<br>Contracts              | Recorded<br>Investment<br>(as of period end) <sup>1</sup> | Number of<br>Contracts              | Investment<br>(as of period end) <sup>1</sup> |
| Commercial                                                                                                          |                                     |                                                           |                                     |                                               |
| Commercial and Industrial                                                                                           | 2                                   | \$ 515                                                    | —                                   | \$ —                                          |
| Total Commercial                                                                                                    | 2                                   | 515                                                       | —                                   | —                                             |
| Consumer                                                                                                            |                                     |                                                           |                                     |                                               |
| Automobile                                                                                                          | 3                                   | 41                                                        | 3                                   | 27                                            |
| Total Consumer                                                                                                      | 3                                   | 41                                                        | 3                                   | 27                                            |
| Total                                                                                                               | 5                                   | \$ 556                                                    | 3                                   | \$ 27                                         |

| TDRs that Defaulted During the Period,<br>Within Twelve Months of their Modification Date<br>(dollars in thousands) | Six Months Ended<br>June 30, 2013 |                                                           | Six Months Ended<br>June 30, 2012 |                                               |
|---------------------------------------------------------------------------------------------------------------------|-----------------------------------|-----------------------------------------------------------|-----------------------------------|-----------------------------------------------|
|                                                                                                                     | Number of<br>Contracts            | Recorded<br>Investment<br>(as of period end) <sup>1</sup> | Number of<br>Contracts            | Investment<br>(as of period end) <sup>1</sup> |
| Commercial                                                                                                          |                                   |                                                           |                                   |                                               |
| Commercial and Industrial                                                                                           | 2                                 | \$ 515                                                    | —                                 | \$ —                                          |
| Total Commercial                                                                                                    | 2                                 | 515                                                       | —                                 | —                                             |
| Consumer                                                                                                            |                                   |                                                           |                                   |                                               |
| Residential Mortgage                                                                                                | —                                 | —                                                         | 2                                 | 702                                           |
| Automobile                                                                                                          | 6                                 | 69                                                        | 4                                 | 37                                            |
| Total Consumer                                                                                                      | 6                                 | 69                                                        | 6                                 | 739                                           |
| Total                                                                                                               | 8                                 | \$ 584                                                    | 6                                 | \$ 739                                        |

<sup>1</sup> The period end balances reflect all paydowns and charge-offs since the modification date. TDRs fully paid-off, charged-off, or foreclosed upon by period end are not included.

Commercial and consumer loans modified in a TDR are closely monitored for delinquency as an early indicator of possible future default. If loans modified in a TDR subsequently default, the Company evaluates the loan for possible further impairment. The specific Allowance associated with the loan may be increased, adjustments may be made in the allocation of the Allowance, or partial charge-offs may be taken to further write-down the carrying value of the loan.

#### Note 4. Mortgage Servicing Rights

The Company's portfolio of residential mortgage loans serviced for third parties was \$3.1 billion as of June 30, 2013 and December 31, 2012. Generally, the Company's residential mortgage loans sold to third parties are sold on a non-recourse basis. The Company's mortgage servicing activities include collecting principal, interest, and escrow payments from borrowers; making tax and insurance payments on behalf of borrowers; monitoring delinquencies and executing foreclosure proceedings; and accounting for and remitting principal and interest payments to investors. Servicing income, including late and ancillary fees, was \$2.0 million and \$2.1 million for the three months ended June 30, 2013 and 2012, respectively, and \$4.0 million and \$4.2 million for the six months ended June 30, 2013 and 2012, respectively. Servicing income is recorded as a component of mortgage banking income in the Company's

consolidated statements of income. The Company's residential mortgage investor loan servicing portfolio is primarily comprised of fixed rate loans concentrated in Hawaii.

For the three and six months ended June 30, 2013 and 2012, the change in the carrying value of the Company's mortgage servicing rights accounted for under the fair value measurement method was as follows:

|                                                          | Three Months Ended<br>June 30, |         | Six Months Ended<br>June 30, |         |
|----------------------------------------------------------|--------------------------------|---------|------------------------------|---------|
| (dollars in thousands)                                   | 2013                           | 2012    | 2013                         | 2012    |
| Balance at Beginning of Period                           | \$4,436                        | \$6,423 | \$4,761                      | \$7,131 |
| Change in Fair Value:                                    |                                |         |                              |         |
| Due to Change in Valuation Assumptions <sup>1</sup>      | 30                             | (568)   | 64                           | (881)   |
| Due to Payoffs                                           | (308)                          | (396)   | (667)                        | (791)   |
| Total Changes in Fair Value of Mortgage Servicing Rights | (278)                          | (964)   | (603)                        | (1,672) |
| Balance at End of Period                                 | \$4,158                        | \$5,459 | \$4,158                      | \$5,459 |

<sup>1</sup> Principally represents changes in discount rates and loan repayment rate assumptions, mostly due to changes in interest rates.

For the three and six months ended June 30, 2013 and 2012, the change in the carrying value of the Company's mortgage servicing rights accounted for under the amortization method was as follows:

|                                                     | Three Months Ended<br>June 30, |          | Six Months Ended<br>June 30, |          |
|-----------------------------------------------------|--------------------------------|----------|------------------------------|----------|
| (dollars in thousands)                              | 2013                           | 2012     | 2013                         | 2012     |
| Balance at Beginning of Period                      | \$22,104                       | \$17,492 | \$20,479                     | \$17,148 |
| Servicing Rights that Resulted From Asset Transfers | 2,003                          | 961      | 4,253                        | 1,969    |
| Amortization                                        | (634)                          | (658)    | (1,259)                      | (1,322)  |
| Balance at End of Period                            | \$23,473                       | \$17,795 | \$23,473                     | \$17,795 |

#### Fair Value of Mortgage Servicing Rights Accounted for

##### Under the Amortization Method

|                     |          |          |          |          |
|---------------------|----------|----------|----------|----------|
| Beginning of Period | \$26,564 | \$20,406 | \$23,143 | \$17,159 |
| End of Period       | \$28,442 | \$18,937 | \$28,442 | \$18,937 |

The key data and assumptions used in estimating the fair value of the Company's mortgage servicing rights as of June 30, 2013 and December 31, 2012 were as follows:

|                                                        | June 30,<br>2013 |   | December<br>31, 2012 |   |
|--------------------------------------------------------|------------------|---|----------------------|---|
| Weighted-Average Constant Prepayment Rate <sup>1</sup> | 9.88             | % | 12.26                | % |
| Weighted-Average Life (in years)                       | 7.21             |   | 6.24                 |   |
| Weighted-Average Note Rate                             | 4.38             | % | 4.59                 | % |
| Weighted-Average Discount Rate <sup>2</sup>            | 6.31             | % | 5.57                 | % |

<sup>1</sup> Represents annualized loan repayment rate assumption.

<sup>2</sup> Derived from multiple interest rate scenarios that incorporate a spread to the London Interbank Offered Rate swap curve and market volatilities.

A sensitivity analysis of the Company's fair value of mortgage servicing rights to changes in certain key assumptions as of June 30, 2013 and December 31, 2012 is presented in the following table.

| (dollars in thousands)                                             | June 30,<br>2013 |   | December 31,<br>2012 |   |
|--------------------------------------------------------------------|------------------|---|----------------------|---|
| Constant Prepayment Rate                                           |                  |   |                      |   |
| Decrease in fair value from 25 basis points ("bps") adverse change | \$(411)          | ) | \$(378)              | ) |
| Decrease in fair value from 50 bps adverse change                  | (811)            | ) | (746)                | ) |
| Discount Rate                                                      |                  |   |                      |   |

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|                                                   |      |   |      |   |
|---------------------------------------------------|------|---|------|---|
| Decrease in fair value from 25 bps adverse change | (490 | ) | (439 | ) |
| Decrease in fair value from 50 bps adverse change | (967 | ) | (864 | ) |

This analysis generally cannot be extrapolated because the relationship of a change in one key assumption to the change in the fair value of the Company's mortgage servicing rights usually is not linear. Also, the effect of changing one key assumption without changing other assumptions is not realistic.

Note 5. Assets and Liabilities Subject to Enforceable Master Netting Arrangements

Interest Rate Swap Agreements (“Swap Agreements”)

The Company enters into swap agreements to facilitate the risk management strategies of a small number of commercial banking customers. The Company mitigates the risk of entering into these agreements by entering into equal and offsetting swap agreements with highly rated third party financial institutions. The swap agreements are free-standing derivatives and are recorded at fair value in the Company's consolidated statements of condition. 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 master netting arrangements provide for a single net settlement of all swap agreements, as well as collateral, in the event of default on, or termination of, any one contract. Collateral, usually in the form of marketable securities, is posted by the counterparty with net liability positions in accordance with contract thresholds. The Company had net liability positions with its financial institution counterparties totaling \$24.0 million and \$32.4 million as of June 30, 2013 and December 31, 2012, respectively. The collateral posted by the Company for these net liability positions was \$2.6 million and \$3.1 million as of June 30, 2013 and December 31, 2012, respectively. See Note 10 to the Consolidated Financial Statements for more information.

Securities Sold Under Agreements to Repurchase (“Repurchase Agreements”)

The Company enters into agreements under which it sells securities subject to an obligation to repurchase the same or similar securities. Under these arrangements, the Company may transfer legal control over the assets but still retain effective control through an agreement that both entitles and obligates the Company to repurchase the assets. As a result, these repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities. The obligation to repurchase the securities is reflected as a liability in the Company's consolidated statements of condition, while the securities underlying the repurchase agreements remain in the respective investment securities asset accounts. In other words, there is no offsetting or netting of the investment securities assets with the repurchase agreement liabilities. In addition, as the Company does not enter into reverse repurchase agreements, there is no such offsetting to be done with the repurchase agreements.

The right of setoff for a repurchase agreement resembles a secured borrowing, whereby the collateral would be used to settle the fair value of the repurchase agreement should the Company be in default (e.g., fails to make an interest payment to the counterparty). For private institution repurchase agreements, if the private institution counterparty were to default (e.g., declare bankruptcy), the Company could cancel the repurchase agreement (i.e., cease payment of principal and interest), and attempt collection on the amount of collateral value in excess of the repurchase agreement fair value. The collateral is held by a third party financial institution in the counterparty's custodial account. The counterparty has the right to sell or repledge the investment securities. For government entity repurchase agreements, the collateral is held by the Company in a segregated custodial account under a tri-party agreement.

The following table presents the assets and liabilities subject to an enforceable master netting arrangement or repurchase agreements as of June 30, 2013 and December 31, 2012. The swap agreements we have with our commercial banking customers are not subject to an enforceable master netting arrangement, and therefore, are excluded from this table.

| (dollars in thousands) | Gross<br>Amounts<br>Recognized in<br>the<br>Statements<br>of Condition | Gross<br>Amounts<br>Offset in the<br>Statements<br>of Condition | Net Amounts<br>Presented in<br>the<br>Statements<br>of Condition | Gross Amounts Not<br>Offset in the Statements of<br>Condition | Financial<br>Instruments | Cash<br>Collateral<br>Pledged | Net<br>Amount |
|------------------------|------------------------------------------------------------------------|-----------------------------------------------------------------|------------------------------------------------------------------|---------------------------------------------------------------|--------------------------|-------------------------------|---------------|
| June 30, 2013          |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Assets:                |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Interest Rate Swap     |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Agreements:            |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Institutional          |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Counterparties         | (a) \$ 158                                                             | \$—                                                             | \$ 158                                                           | \$(158 )                                                      | \$—                      |                               | \$—           |
| Liabilities:           |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Interest Rate Swap     |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Agreements:            |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Institutional          |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Counterparties         | (a) \$ 24,204                                                          | \$—                                                             | \$ 24,204                                                        | \$(24,204 )                                                   | \$—                      |                               | \$—           |
| Repurchase Agreements: |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Private Institutions   | (b) 600,000                                                            | —                                                               | 600,000                                                          | (600,000 )                                                    | —                        |                               | —             |
| Government Entities    | (c) 266,237                                                            | —                                                               | 266,237                                                          | (266,237 )                                                    | —                        |                               | —             |
|                        | \$ 866,237                                                             | \$—                                                             | \$ 866,237                                                       | \$(866,237 )                                                  | \$—                      |                               | \$—           |
| December 31, 2012      |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Liabilities:           |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Interest Rate Swap     |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Agreements:            |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Institutional          |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Counterparties         | (a) \$ 32,441                                                          | \$—                                                             | \$ 32,441                                                        | \$(32,441 )                                                   | \$—                      |                               | \$—           |
| Repurchase Agreements: |                                                                        |                                                                 |                                                                  |                                                               |                          |                               |               |
| Private Institutions   | (b) 600,000                                                            | —                                                               | 600,000                                                          | (600,000 )                                                    | —                        |                               | —             |
| Government Entities    | (c) 158,947                                                            | —                                                               | 158,947                                                          | (158,947 )                                                    | —                        |                               | —             |
|                        | \$ 758,947                                                             | \$—                                                             | \$ 758,947                                                       | \$(758,947 )                                                  | \$—                      |                               | \$—           |

(a) Collateral is posted by the counterparty with net liability positions in accordance with contract thresholds. As of June 30, 2013 and December 31, 2012, the fair value of securities pledged by the Company was \$2.6 million and \$3.1 million, respectively.

(b) As of June 30, 2013 and December 31, 2012, the fair value of securities pledged was \$0.7 billion and \$0.8 billion, respectively.

(c) The investment securities pledged to each government entity collectively secure both deposits as well as repurchase agreements. The Company had government entity deposits totaling \$1.3 billion and \$1.4 billion as of June 30, 2013 and December 31, 2012, respectively. The investment securities pledged as of June 30, 2013 and December 31, 2012 had a fair value of \$2.0 billion and \$2.2 billion, respectively.



# Note 6. Accumulated Other Comprehensive Income (Loss)

The following table presents the components of other comprehensive income (loss) for the three and six months ended June 30, 2013 and 2012:

| (dollars in thousands)                                                          | Before Tax  | Tax Effect  | Net of Tax  |
|---------------------------------------------------------------------------------|-------------|-------------|-------------|
| Three Months Ended June 30, 2013                                                |             |             |             |
| Net Unrealized Losses on Investment Securities:                                 |             |             |             |
| Net Unrealized Losses Arising During the Period                                 | \$(73,912 ) | \$(29,136 ) | \$(44,776 ) |
| Less: Reclassification Adjustment for Gains Realized in Net Income <sup>1</sup> | (2,966 )    | (1,170 )    | (1,796 )    |
| Net Unrealized Losses on Investment Securities                                  | (76,878 )   | (30,306 )   | (46,572 )   |
| Defined Benefit Plans:                                                          |             |             |             |
| Amortization of Net Actuarial Losses                                            | 413         | 163         | 250         |
| Amortization of Prior Service Credit                                            | (81 )       | (32 )       | (49 )       |
| Defined Benefit Plans, Net                                                      | 332         | 131         | 201         |
| Other Comprehensive Loss                                                        | \$(76,546 ) | \$(30,175 ) | \$(46,371 ) |
| Three Months Ended June 30, 2012                                                |             |             |             |
| Net Unrealized Gains on Investment Securities:                                  |             |             |             |
| Net Unrealized Gains Arising During the Period                                  | \$9,582     | \$3,808     | \$5,774     |
| Less: Reclassification Adjustment for Gains Realized in Net Income <sup>1</sup> | (3,939 )    | (1,552 )    | (2,387 )    |
| Net Unrealized Gains on Investment Securities                                   | 5,643       | 2,256       | 3,387       |
| Defined Benefit Plans:                                                          |             |             |             |
| Amortization of Net Actuarial Losses                                            | 335         | 132         | 203         |
| Amortization of Prior Service Credit                                            | (81 )       | (31 )       | (50 )       |
| Defined Benefit Plans, Net                                                      | 254         | 101         | 153         |
| Other Comprehensive Income                                                      | \$5,897     | \$2,357     | \$3,540     |
| Six Months Ended June 30, 2013                                                  |             |             |             |
| Net Unrealized Losses on Investment Securities:                                 |             |             |             |
| Net Unrealized Losses Arising During the Period                                 | \$(86,507 ) | \$(34,093 ) | \$(52,414 ) |
| Less: Reclassification Adjustment for Gains Realized in Net Income <sup>1</sup> | (6,273 )    | (2,474 )    | (3,799 )    |
| Net Unrealized Losses on Investment Securities                                  | (92,780 )   | (36,567 )   | (56,213 )   |
| Defined Benefit Plans:                                                          |             |             |             |
| Net Actuarial Losses Arising During the Period                                  | (206 )      | (81 )       | (125 )      |
| Amortization of Net Actuarial Losses                                            | 827         | 326         | 501         |
| Amortization of Prior Service Credit                                            | (161 )      | (64 )       | (97 )       |
| Defined Benefit Plans, Net                                                      | 460         | 181         | 279         |
| Other Comprehensive Loss                                                        | \$(92,320 ) | \$(36,386 ) | \$(55,934 ) |
| Six Months Ended June 30, 2012                                                  |             |             |             |
| Net Unrealized Losses on Investment Securities:                                 |             |             |             |
| Net Unrealized Gains Arising During the Period                                  | \$2,996     | \$1,236     | \$1,760     |
| Less: Reclassification Adjustment for Gains Realized in Net Income <sup>1</sup> | (7,963 )    | (3,136 )    | (4,827 )    |
| Net Unrealized Losses on Investment Securities                                  | (4,967 )    | (1,900 )    | (3,067 )    |
| Defined Benefit Plans:                                                          |             |             |             |

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|                                      |          |   |          |   |          |
|--------------------------------------|----------|---|----------|---|----------|
| Amortization of Net Actuarial Losses | 667      |   | 262      |   | 405      |
| Amortization of Prior Service Credit | (162     | ) | (63      | ) | (99      |
| Defined Benefit Plans, Net           | 505      |   | 199      |   | 306      |
| Other Comprehensive Loss             | \$(4,462 | ) | \$(1,701 | ) | \$(2,761 |

Includes amounts related to the amortization/accretion of unrealized net gains and losses related to the Company's  
<sup>1</sup> reclassification of available-for-sale investment securities to the held-to-maturity category. The unrealized net gains/losses will be amortized/accreted over the remaining life of the investment securities as an adjustment of yield.

The following table presents the changes in each component of accumulated other comprehensive income (loss), net of tax, for the three and six months ended June 30, 2013 and 2012:

| (dollars in thousands)                                                 | Investment<br>Securities-Available-for-Sale | Investment<br>Securities-Held-to-Maturity | Defined<br>Benefit<br>Plans <sup>1</sup> | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) |
|------------------------------------------------------------------------|---------------------------------------------|-------------------------------------------|------------------------------------------|-----------------------------------------------------------|
| <b>Three Months Ended June 30, 2013</b>                                |                                             |                                           |                                          |                                                           |
| Balance at Beginning of Period                                         | \$ 38,358                                   | \$ 11,778                                 | \$(30,491)                               | ) \$19,645                                                |
| Other Comprehensive Loss Before<br>Reclassifications                   | (39,641)                                    | ) (5,135)                                 | ) —                                      | (44,776)                                                  |
| Amounts Reclassified from<br>Accumulated Other<br>Comprehensive Income | —                                           | (1,796)                                   | ) 201                                    | (1,595)                                                   |
| Total Other Comprehensive Income<br>(Loss)                             | (39,641)                                    | ) (6,931)                                 | ) 201                                    | (46,371)                                                  |
| Balance at End of Period                                               | \$ (1,283)                                  | ) \$ 4,847                                | \$(30,290)                               | ) \$(26,726)                                              |
| <b>Three Months Ended June 30, 2012</b>                                |                                             |                                           |                                          |                                                           |
| Balance at Beginning of Period                                         | \$ 35,436                                   | \$ 21,043                                 | \$(27,517)                               | ) \$28,962                                                |
| Other Comprehensive Income Before<br>Reclassifications                 | 5,774                                       | —                                         | —                                        | 5,774                                                     |
| Amounts Reclassified from<br>Accumulated Other<br>Comprehensive Income | —                                           | (2,387)                                   | ) 153                                    | (2,234)                                                   |
| Total Other Comprehensive Income<br>(Loss)                             | 5,774                                       | (2,387)                                   | ) 153                                    | 3,540                                                     |
| Balance at End of Period                                               | \$ 41,210                                   | \$ 18,656                                 | \$(27,364)                               | ) \$32,502                                                |
| <b>Six Months Ended June 30, 2013</b>                                  |                                             |                                           |                                          |                                                           |
| Balance at Beginning of Period                                         | \$ 45,996                                   | \$ 13,781                                 | \$(30,569)                               | ) \$29,208                                                |
| Other Comprehensive Loss Before<br>Reclassifications                   | (47,279)                                    | ) (5,135)                                 | ) (125)                                  | (52,539)                                                  |
| Amounts Reclassified from<br>Accumulated Other<br>Comprehensive Income | —                                           | (3,799)                                   | ) 404                                    | (3,395)                                                   |
| Total Other Comprehensive Income<br>(Loss)                             | (47,279)                                    | ) (8,934)                                 | ) 279                                    | (55,934)                                                  |
| Balance at End of Period                                               | \$ (1,283)                                  | ) \$ 4,847                                | \$(30,290)                               | ) \$(26,726)                                              |
| <b>Six Months Ended June 30, 2012</b>                                  |                                             |                                           |                                          |                                                           |
| Balance at Beginning of Period                                         | \$ 39,396                                   | \$ 23,537                                 | \$(27,670)                               | ) \$35,263                                                |
| Other Comprehensive Income Before<br>Reclassifications                 | 1,760                                       | —                                         | —                                        | 1,760                                                     |
| Amounts Reclassified from<br>Accumulated Other<br>Comprehensive Income | 54                                          | (4,881)                                   | ) 306                                    | (4,521)                                                   |
| Total Other Comprehensive Income<br>(Loss)                             | 1,814                                       | (4,881)                                   | ) 306                                    | (2,761)                                                   |

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|                          |           |           |             |          |
|--------------------------|-----------|-----------|-------------|----------|
| Balance at End of Period | \$ 41,210 | \$ 18,656 | \$(27,364 ) | \$32,502 |
|--------------------------|-----------|-----------|-------------|----------|

<sup>1</sup> Amounts in parentheses indicate debits.

26

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The following table presents the amounts reclassified out of each component of accumulated other comprehensive income (loss) for the three and six months ended June 30, 2013 and 2012:

| Details about Accumulated Other Comprehensive Income (Loss) Components                                                             | Amount Reclassified from Accumulated Other Comprehensive Income(Loss) <sup>1</sup> | Affected Line Item in the Statement Where Net Income Is Presented |                 |
|------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------|-------------------------------------------------------------------|-----------------|
|                                                                                                                                    | Three Months Ended June 30,                                                        |                                                                   |                 |
| (dollars in thousands)                                                                                                             | 2013                                                                               | 2012                                                              |                 |
| Amortization of Unrealized Holding Gains (Losses) on Investment Securities Transferred from Available-for-Sale to Held-to-Maturity | \$2,966                                                                            | \$3,939                                                           | Interest Income |
|                                                                                                                                    | (1,170)                                                                            | )(1,552                                                           | ) Tax Expense   |
|                                                                                                                                    | 1,796                                                                              | 2,387                                                             | Net of Tax      |
| Amortization of Defined Benefit Plan Items                                                                                         |                                                                                    |                                                                   |                 |
| Prior Service Credit <sup>2</sup>                                                                                                  | 81                                                                                 | 81                                                                |                 |
| Net Actuarial Losses <sup>2</sup>                                                                                                  | (413)                                                                              | )(335                                                             | )               |
|                                                                                                                                    | (332)                                                                              | )(254                                                             | ) Total Before  |
|                                                                                                                                    | 131                                                                                | 101                                                               | ) Tax           |
|                                                                                                                                    | (201)                                                                              | )(153                                                             | ) Tax Benefit   |
|                                                                                                                                    |                                                                                    |                                                                   | ) Net of Tax    |
| Total Reclassifications for the Period                                                                                             | \$1,595                                                                            | \$2,234                                                           | Net of Tax      |

| Details about Accumulated Other Comprehensive Income (Loss) Components                                                             | Amount Reclassified from Accumulated Other Comprehensive Income (Loss) <sup>1</sup> | Affected Line Item in the Statement Where Net Income Is Presented |                 |
|------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------|-------------------------------------------------------------------|-----------------|
|                                                                                                                                    | Six Months Ended June 30,                                                           |                                                                   |                 |
| (dollars in thousands)                                                                                                             | 2013                                                                                | 2012                                                              |                 |
| Amortization of Unrealized Holding Gains (Losses) on Investment Securities Transferred from Available-for-Sale to Held-to-Maturity | \$6,273                                                                             | \$8,053                                                           | Interest Income |
|                                                                                                                                    | (2,474)                                                                             | )(3,172                                                           | ) Tax Expense   |
|                                                                                                                                    | 3,799                                                                               | 4,881                                                             | Net of Tax      |
| Sale of Investment Securities Available-for-Sale                                                                                   | —                                                                                   | (90                                                               | ) Investment    |
|                                                                                                                                    | —                                                                                   | 36                                                                | ) Securities    |
|                                                                                                                                    | —                                                                                   | (54                                                               | ) Losses, Net   |
|                                                                                                                                    |                                                                                     |                                                                   | ) Tax Benefit   |
|                                                                                                                                    |                                                                                     |                                                                   | ) Net of tax    |
| Amortization of Defined Benefit Plan Items                                                                                         |                                                                                     |                                                                   |                 |
| Prior Service Credit <sup>2</sup>                                                                                                  | 161                                                                                 | 162                                                               |                 |

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|                                        |         |         |                |
|----------------------------------------|---------|---------|----------------|
| Net Actuarial Losses <sup>2</sup>      | (827    | )(667   | )              |
|                                        | (666    | )(505   | ) Total Before |
|                                        |         |         | Tax            |
|                                        | 262     | 199     | Tax Benefit    |
|                                        | (404    | )(306   | ) Net of Tax   |
| Total Reclassifications for the Period | \$3,395 | \$4,521 | Net of Tax     |

<sup>1</sup> Amounts in parentheses indicate reductions to net income.

These accumulated other comprehensive income (loss) components are included in the computation of net periodic

<sup>2</sup> benefit cost and are included in Salaries and Benefits on the consolidated statements of income (see Note 9 for additional details).

## Note 7. Earnings Per Share

There were no adjustments to net income, the numerator, for purposes of computing earnings per share. The following is a reconciliation of the weighted average number of common shares outstanding for computing diluted earnings per share and antidilutive stock options and restricted stock outstanding for the three and six months ended June 30, 2013 and 2012:

|                                                             | Three Months Ended<br>June 30, |            | Six Months Ended<br>June 30, |            |
|-------------------------------------------------------------|--------------------------------|------------|------------------------------|------------|
|                                                             | 2013                           | 2012       | 2013                         | 2012       |
| Denominator for Basic Earnings Per Share                    | 44,493,069                     | 45,221,293 | 44,518,629                   | 45,465,910 |
| Dilutive Effect of Stock Options                            | 72,016                         | 106,502    | 75,527                       | 123,706    |
| Dilutive Effect of Restricted Stock                         | 43,412                         | 19,573     | 50,192                       | 20,873     |
| Denominator for Diluted Earnings Per Share                  | 44,608,497                     | 45,347,368 | 44,644,348                   | 45,610,489 |
| Antidilutive Stock Options and Restricted Stock Outstanding | 170,372                        | 537,383    | 170,372                      | 537,383    |

## Note 8. Business Segments

The Company's business segments are defined as Retail Banking, Commercial Banking, Investment Services, and Treasury and Other. The Company's internal management accounting process measures the performance of the business segments based on the management structure of the Company. 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 credit 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. Previously reported results have been reclassified to conform to the current organizational reporting structure.

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. However, the other business segments have some latitude to retain certain interest rate exposures related to customer pricing decisions within guidelines.

The provision for credit losses reflects the actual net charge-offs of the business segments. This may be adjusted periodically for changes in the risk profile of the business segment. The amount of the consolidated provision for loan and lease losses is based on the methodology that we use to estimate our consolidated Allowance. The residual provision for credit losses to arrive at the consolidated provision for credit losses is included in Treasury and Other.

Implicit in noninterest income and expense are allocations from support units to business units. These allocations are based on actual usage where practicably calculated or by management's estimate of such usage.

The provision for income taxes is allocated to business segments using a 37% effective tax rate, with the exception of our Leasing business unit which is assigned its actual effective tax rate due to the unique relationship that income taxes have with their leasing products. The residual income tax expense or benefit to arrive at the consolidated effective tax rate is included in Treasury and Other.

## Retail Banking

Retail Banking offers a broad range of financial products and services to consumers and small businesses. Loan and lease products include residential mortgage loans, home equity lines of credit, automobile loans and leases, personal lines of credit, installment loans, small business loans and leases, and credit cards. Deposit products include checking, savings, and time deposit accounts. Retail Banking also offers retail insurance products. Products and services from Retail Banking are delivered to customers through 66 Hawaii branch locations, 486 ATMs throughout Hawaii and the Pacific Islands, e-Bankoh (on-line banking service), a 24-hour customer service center, and a mobile banking service.

## Commercial Banking

Commercial Banking offers products including corporate banking, commercial real estate loans, commercial lease financing, auto dealer financing, and deposit products. Commercial lending and deposit products are offered to middle-market and large companies in Hawaii. Commercial real estate mortgages focus on customers that include investors, developers, and builders predominantly domiciled in Hawaii. Commercial Banking also includes international banking and operations at the Bank's 9 branches in the Pacific Islands and also provides merchant services to its small business customers.

## Investment Services

Investment Services includes private banking, trust services, investment management, and institutional investment advisory services. A significant portion of this segment's income is derived from fees, which are generally based on the market values of assets under management. The private banking and personal trust group assists individuals and families in building and preserving their wealth by providing investment, credit, and trust services to high-net-worth individuals. The investment management group manages portfolios utilizing a variety of investment products. Institutional client services offer investment advice to corporations, government entities, and foundations. This segment also provides a full service brokerage offering equities, mutual funds, life insurance, and annuity products.

## Treasury and Other

Treasury consists of corporate asset and liability management activities, including interest rate risk management and a foreign currency exchange business. This 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, and short and long-term borrowings. The primary sources of noninterest income are from bank-owned life insurance, net gains from the sale of investment securities, and foreign exchange income related to customer-driven currency requests from merchants and island visitors. 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, Marketing, Human Resources, Finance, Credit and Risk Management, 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.

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Selected business segment financial information as of and for the three and six months ended June 30, 2013 and 2012 were as follows:

| (dollars in thousands)                                | Retail<br>Banking | Commercial<br>Banking | Investment<br>Services | Treasury<br>and Other | Consolidated<br>Total |
|-------------------------------------------------------|-------------------|-----------------------|------------------------|-----------------------|-----------------------|
| Three Months Ended June 30, 2013                      |                   |                       |                        |                       |                       |
| Net Interest Income                                   | \$35,725          | \$28,554              | \$2,594                | \$20,467              | \$87,340              |
| Provision for Credit Losses                           | 1,857             | 472                   | (12)                   | (2,317)               | —                     |
| Net Interest Income After Provision for Credit Losses | 33,868            | 28,082                | 2,606                  | 22,784                | 87,340                |
| Noninterest Income                                    | 20,871            | 9,117                 | 15,288                 | 2,765                 | 48,041                |
| Noninterest Expense                                   | (43,540)          | (22,011)              | (13,135)               | (2,495)               | (81,181)              |
| Income Before Provision for Income Taxes              | 11,199            | 15,188                | 4,759                  | 23,054                | 54,200                |
| Provision for Income Taxes                            | (4,144)           | (5,177)               | (1,761)                | (5,355)               | (16,437)              |
| Net Income                                            | \$7,055           | \$10,011              | \$2,998                | \$17,699              | \$37,763              |
| Total Assets as of June 30, 2013                      | \$3,283,634       | \$2,567,461           | \$188,871              | \$7,693,452           | \$13,733,418          |
| Three Months Ended June 30, 2012                      |                   |                       |                        |                       |                       |
| Net Interest Income                                   | \$39,118          | \$30,817              | \$3,150                | \$22,296              | \$95,381              |
| Provision for Credit Losses                           | 3,334             | 157                   | 301                    | (3,164)               | 628                   |
| Net Interest Income After Provision for Credit Losses | 35,784            | 30,660                | 2,849                  | 25,460                | 94,753                |
| Noninterest Income                                    | 22,376            | 8,552                 | 14,071                 | 1,849                 | 46,848                |
| Noninterest Expense                                   | (44,164)          | (21,577)              | (13,415)               | (1,591)               | (80,747)              |
| Income Before Provision for Income Taxes              | 13,996            | 17,635                | 3,505                  | 25,718                | 60,854                |
| Provision for Income Taxes                            | (5,178)           | (6,042)               | (1,297)                | (7,590)               | (20,107)              |
| Net Income                                            | \$8,818           | \$11,593              | \$2,208                | \$18,128              | \$40,747              |
| Total Assets as of June 30, 2012                      | \$3,344,319       | \$2,289,255           | \$189,008              | \$8,093,044           | \$13,915,626          |
| Six Months Ended June 30, 2013                        |                   |                       |                        |                       |                       |
| Net Interest Income                                   | \$71,634          | \$58,426              | \$5,365                | \$40,475              | \$175,900             |
| Provision for Credit Losses                           | 4,035             | 301                   | (33)                   | (4,303)               | —                     |
| Net Interest Income After Provision for Credit Losses | 67,599            | 58,125                | 5,398                  | 44,778                | 175,900               |
| Noninterest Income                                    | 41,355            | 18,517                | 30,098                 | 5,849                 | 95,819                |
| Noninterest Expense                                   | (87,994)          | (44,895)              | (27,270)               | (5,409)               | (165,568)             |
| Income Before Provision for Income Taxes              | 20,960            | 31,747                | 8,226                  | 45,218                | 106,151               |
| Provision for Income Taxes                            | (7,755)           | (10,849)              | (3,044)                | (10,760)              | (32,408)              |
| Net Income                                            | \$13,205          | \$20,898              | \$5,182                | \$34,458              | \$73,743              |
| Total Assets as of June 30, 2013                      | \$3,283,634       | \$2,567,461           | \$188,871              | \$7,693,452           | \$13,733,418          |
| Six Months Ended June 30, 2012                        |                   |                       |                        |                       |                       |
| Net Interest Income                                   | \$79,303          | \$62,259              | \$6,483                | \$45,284              | \$193,329             |
| Provision for Credit Losses                           | 7,364             | (511)                 | 289                    | (6,163)               | 979                   |
| Net Interest Income After Provision for Credit Losses | 71,939            | 62,770                | 6,194                  | 51,447                | 192,350               |
| Noninterest Income                                    | 41,916            | 20,129                | 27,741                 | 5,144                 | 94,930                |

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|                                          |             |             |           |             |              |   |
|------------------------------------------|-------------|-------------|-----------|-------------|--------------|---|
| Noninterest Expense                      | (88,776     | ) (45,099   | ) (28,177 | ) (3,902    | ) (165,954   | ) |
| Income Before Provision for Income Taxes | 25,079      | 37,800      | 5,758     | 52,689      | 121,326      |   |
| Provision for Income Taxes               | (9,279      | ) (9,063    | ) (2,130  | ) (16,297   | ) (36,769    | ) |
| Net Income                               | \$15,800    | \$28,737    | \$3,628   | \$36,392    | \$84,557     |   |
| Total Assets as of June 30, 2012         | \$3,344,319 | \$2,289,255 | \$189,008 | \$8,093,044 | \$13,915,626 |   |

## Note 9. Pension Plans and Postretirement Benefit Plan

Components of net periodic benefit cost for the Company's pension plans and the postretirement benefit plan are presented in the following table for the three and six months ended June 30, 2013 and 2012.

| (dollars in thousands)         | Pension Benefits |         | Postretirement Benefits |       |
|--------------------------------|------------------|---------|-------------------------|-------|
|                                | 2013             | 2012    | 2013                    | 2012  |
| Three Months Ended June 30,    |                  |         |                         |       |
| Service Cost                   | \$—              | \$—     | \$173                   | \$145 |
| Interest Cost                  | 1,129            | 1,263   | 305                     | 319   |
| Expected Return on Plan Assets | (1,313)          | (1,449) | —                       | —     |
| Amortization of:               |                  |         |                         |       |
| Prior Service Credit           | —                | —       | (81)                    | (81)  |
| Net Actuarial Losses           | 413              | 335     | —                       | —     |
| Net Periodic Benefit Cost      | \$229            | \$149   | \$397                   | \$383 |
| Six Months Ended June 30,      |                  |         |                         |       |
| Service Cost                   | \$—              | \$—     | \$205                   | \$290 |
| Interest Cost                  | 2,257            | 2,526   | 362                     | 639   |
| Expected Return on Plan Assets | (2,626)          | (3,017) | —                       | —     |
| Amortization of:               |                  |         |                         |       |
| Prior Service Credit           | —                | —       | (161)                   | (162) |
| Net Actuarial Losses           | 827              | 667     | —                       | —     |
| Net Periodic Benefit Cost      | \$458            | \$176   | \$406                   | \$767 |

The net periodic benefit cost for the Company's pension plans and postretirement benefit plan are recorded as a component of salaries and benefits in the consolidated statements of income. For the three and six months ended June 30, 2013, the Company contributed \$0.1 million and \$0.2 million, respectively, to the pension plans and \$0.2 million and \$0.4 million, respectively, to the postretirement benefit plan. The Company expects to contribute \$0.5 million to the pension plans and \$1.4 million to the postretirement benefit plan for the year ending December 31, 2013.

## Note 10. Derivative Financial Instruments

The following table presents the Company's derivative financial instruments, their fair values, and balance sheet location as of June 30, 2013 and December 31, 2012:

| Derivative Financial Instruments Not Designated as Hedging Instruments <sup>1</sup> (dollars in thousands) | June 30, 2013 |             | December 31, 2012 |             |
|------------------------------------------------------------------------------------------------------------|---------------|-------------|-------------------|-------------|
|                                                                                                            | Asset         | Liability   | Asset             | Liability   |
|                                                                                                            | Derivatives   | Derivatives | Derivatives       | Derivatives |
| Interest Rate Lock Commitments                                                                             | \$1,754       | \$1,953     | \$10,188          | \$—         |
| Forward Commitments                                                                                        | 4,337         | 240         | 189               | 329         |
| Interest Rate Swap Agreements                                                                              | 24,176        | 24,361      | 32,193            | 32,441      |
| Foreign Exchange Contracts                                                                                 | 52            | 184         | 40                | 856         |
| Total                                                                                                      | \$30,319      | \$26,738    | \$42,610          | \$33,626    |

<sup>1</sup> Asset derivatives are included in other assets and liability derivatives are included in other liabilities in the consolidated statements of condition.

The following table presents the Company's derivative financial instruments and the amount and location of the net gains recognized in the consolidated statements of income for the three and six months ended June 30, 2013 and 2012:

| Derivative Financial Instruments | Location of        | Three Months Ended | Six Months Ended |
|----------------------------------|--------------------|--------------------|------------------|
|                                  | Net Gains (Losses) |                    |                  |

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| Not Designated as Hedging<br>Instruments<br>(dollars in thousands) | Recognized in the<br>Statements of Income | June 30, |          | June 30, |          |
|--------------------------------------------------------------------|-------------------------------------------|----------|----------|----------|----------|
|                                                                    |                                           | 2013     | 2012     | 2013     | 2012     |
| Interest Rate Lock Commitments                                     | Mortgage Banking                          | \$(682 ) | \$9,363  | \$2,576  | \$13,066 |
| Forward Commitments                                                | Mortgage Banking                          | 5,433    | (2,028 ) | 7,662    | (1,762 ) |
| Interest Rate Swap Agreements                                      | Other Noninterest<br>Income               | 243      | (11 )    | 263      | 5        |
| Foreign Exchange Contracts                                         | Other Noninterest<br>Income               | 703      | 713      | 1,600    | 1,580    |
| Total                                                              |                                           | \$5,697  | \$8,037  | \$12,101 | \$12,889 |

31

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Management has received authorization from the Bank's Board of Directors to use derivative financial instruments as an end-user in connection with its risk management activities and to accommodate the needs of its customers. As with any financial instrument, derivative financial instruments have inherent risks. Market risk is defined as the risk of adverse financial impact due to fluctuations in interest rates, foreign exchange rates, and equity prices. Market risks associated with derivative financial instruments are balanced with the expected returns to enhance earnings performance and shareholder value, while limiting the volatility of each. The Company uses various processes to monitor its overall market risk exposure, including sensitivity analysis, value-at-risk calculations, and other methodologies.

Derivative financial instruments are also subject to credit and counterparty risk, which is defined as the risk of financial loss if a borrower or counterparty is either unable or unwilling to repay borrowings or settle a transaction in accordance with the underlying contractual terms. Credit and counterparty risks associated with derivative financial instruments are similar to those relating to traditional financial instruments. The Company manages derivative credit and counterparty risk by evaluating the creditworthiness of each borrower or counterparty, adhering to the same credit approval process used for commercial lending activities.

As of June 30, 2013 and December 31, 2012, the Company did not designate any derivative financial instruments in formal hedging relationships. The Company's free-standing derivative financial instruments are required to be carried at their fair value on the Company's consolidated statements of condition. These financial instruments have been limited to interest rate lock commitments ("IRLCs"), forward commitments, interest rate swap agreements, and foreign exchange contracts.

The Company enters IRLCs for residential mortgage loans which commit us to lend funds to a potential borrower at a specific interest rate and within a specified period of time. IRLCs that relate to the origination of mortgage loans that will be held for sale are considered derivative financial instruments under applicable accounting guidance.

Outstanding IRLCs expose the Company to the risk that the price of the mortgage loans underlying the commitments may decline due to increases in mortgage interest rates from inception of the rate lock to the funding of the loan. To mitigate this risk, the Company utilizes forward commitments as economic hedges against the potential decreases in the values of the loans held for sale. The IRLCs and forward commitments are free-standing derivatives which are carried at fair value with changes recorded in the mortgage banking component of noninterest income in the Company's consolidated statements of income. Changes in the fair value of IRLCs and forward commitments subsequent to inception are based on changes in the fair value of the underlying loan resulting from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the commitment, which is affected primarily by changes in interest rates and the passage of time.

The Company enters into interest rate swap agreements to facilitate the risk management strategies of a small number of commercial banking customers. The Company mitigates the risk of entering into these agreements by entering into equal and offsetting interest rate swap agreements with highly rated third party financial institutions. The interest rate swap agreements are free-standing derivatives and are recorded at fair value in the Company's consolidated statements of condition. Fair value changes are recorded in other noninterest income in the Company's consolidated statements of income. 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. Collateral, usually in the form of marketable securities, is posted by the counterparty with net liability positions in accordance with contract thresholds. See Note 5 to the Consolidated Financial Statements for more information.

The Company's interest rate swap agreements with institutional counterparties contain credit-risk-related contingent features tied to the Company's debt ratings or capitalization levels. Under these provisions, if the Company's debt

rating falls below investment grade or if the Company's capitalization levels fall below stipulated thresholds, certain counterparties may require immediate and ongoing collateralization on interest rate swaps in net liability positions, or may require immediate settlement of the contracts. As of June 30, 2013, the Company's debt ratings and capital levels were in excess of these minimum requirements.

The Company utilizes foreign exchange contracts to offset risks related to transactions executed on behalf of customers. The foreign exchange contracts are free-standing derivatives which are carried at fair value with changes included in other noninterest income in the Company's consolidated statements of income.

## Note 11. Commitments, Contingencies, and Guarantees

The Company's credit commitments as of June 30, 2013 and December 31, 2012 were as follows:

| (dollars in thousands)                | June 30,<br>2013 | December 31,<br>2012 |
|---------------------------------------|------------------|----------------------|
| Unfunded Commitments to Extend Credit | \$2,255,270      | \$1,999,542          |
| Standby Letters of Credit             | 60,663           | 62,043               |
| Commercial Letters of Credit          | 15,307           | 13,871               |
| Total Credit Commitments              | \$2,331,240      | \$2,075,456          |

## Unfunded Commitments to Extend Credit

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of the terms or conditions established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since commitments may expire without being drawn, the total commitment amount does not necessarily represent future cash requirements.

## Standby and Commercial Letters of Credit

Standby letters of credit are conditional commitments issued by the Company to guarantee the performance of a customer to a third party. Standby letters of credit generally become payable upon the failure of the customer to perform according to the terms of the underlying contract with the third party, while commercial letters of credit are issued specifically to facilitate commerce and typically result in the commitment being drawn on when the underlying transaction is consummated between the customer and a third party. The contractual amount of these letters of credit represents the maximum potential future payments guaranteed by the Company. The Company has recourse against the customer for any amount it is required to pay to a third party under a standby letter of credit, and holds cash and deposits as collateral on those standby letters of credit for which collateral is deemed necessary.

## Contingencies

The Company is subject to various pending and threatened legal proceedings arising out of the normal course of business or operations. On at least a quarterly basis, the Company assesses its liabilities and contingencies in connection with outstanding legal proceedings utilizing the most recent information available. On a case-by-case basis, reserves are established for those legal claims for which it is probable that a loss will be incurred and the amount of such loss can be reasonably estimated. Based on information currently available, management believes that the eventual outcome of these other actions against the Company will not be materially in excess of such amounts accrued by the Company. However, in the event of unexpected future developments, it is possible that the ultimate resolution of those matters may be material to the Company's consolidated statement of income for any particular period.

## Risks Related to Representation and Warranty Provisions

The Company sells residential mortgage loans in the secondary market primarily to Fannie Mae. The Company also pools Federal Housing Administration ("FHA") insured and U.S. Department of Veterans Affairs ("VA") guaranteed residential mortgage loans for sale to Ginnie Mae. These pools of FHA-insured and VA-guaranteed residential mortgage loans are securitized by Ginnie Mae. The agreements under which the Company sells residential mortgage loans to Fannie Mae or Ginnie Mae and the insurance or guaranty agreements with FHA and VA 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, 2013, the unpaid principal balance of residential mortgage loans sold by the Company was \$3.0 billion. The agreements under which the Company sells 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, the Company may be obligated to repurchase residential mortgage loans if a loan review reveals that underwriting and documentation standards were not met. Upon receipt of a repurchase request, the Company works with investors or insurers 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 or insurer and to determine if a contractually required repurchase event has occurred. The Company manages the risk associated with potential repurchases or other forms of settlement through careful underwriting and quality

assurance practices and by servicing mortgage loans to meet investor and secondary market standards. For the six months ended June 30, 2013, the Company repurchased four residential mortgage loans with an unpaid principal balance totaling \$1.5 million as a result of the representation and warranty provisions contained in these contracts. Three of these loans were delinquent as to principal and interest at the time of repurchase. However, no losses were incurred related to these repurchases. As of June 30, 2013, there was one pending repurchase request for \$0.5 million related to representation and warranty provisions.

#### Risks Relating to Residential Mortgage Loan Servicing Activities

In addition to servicing loans in the Company's portfolio, substantially all of the loans the Company sells to investors are sold with servicing rights retained. The Company also services loans originated by other mortgage loan originators. As servicer, the Company's 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, to the extent consistent with the documents governing a securitization, consider alternatives to foreclosure, such as loan modifications or short sales. Each agreement under which the Company acts 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 the Company commits a material breach of obligations as servicer, the Company 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. As of June 30, 2013, there were no pending repurchase requests related to loan servicing activities.

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, 2013, 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, 2013, 99% of the Company's residential mortgage loans serviced for investors were current. The Company maintains ongoing communications with investors and continues to evaluate this exposure by monitoring the level and number of repurchase requests as well as the delinquency rates in the Company's investor portfolios.

## Note 12. Fair Value of Assets and Liabilities

### Fair Value Hierarchy

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market for an asset or liability in an orderly transaction between market participants at the measurement date. GAAP established a fair value hierarchy that prioritizes the use of inputs used in valuation methodologies into the following three levels:

- Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available. A contractually binding sales price also provides reliable evidence of fair value.
- Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that utilize model-based techniques for which all significant assumptions are observable in the market.
- Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement; inputs to the valuation methodology that utilize model-based techniques for which significant assumptions are not observable in the market; or inputs to the valuation methodology that require significant management judgment or estimation, some of which may be internally developed.

Management maximizes the use of observable inputs and minimizes the use of unobservable inputs when determining fair value measurements. Management reviews and updates the fair value hierarchy classifications of the Company's assets and liabilities on a quarterly basis.

### Assets and Liabilities Measured at Fair Value on a Recurring Basis

#### Investment Securities Available-for-Sale

Fair values of investment securities available-for-sale were primarily measured using information from a third-party pricing service. This service provides pricing information by utilizing evaluated pricing models supported with market data information. Standard inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data from market research publications. Level 1 investment securities are comprised of debt securities issued by the U.S. Treasury. As quoted prices were available, unadjusted, for identical securities in active markets, these securities were classified as Level 1 measurements. Level 2 investment securities were primarily comprised of debt securities issued by the Small Business Administration, states and municipalities, corporations, as well as mortgage-backed securities issued by government agencies. Fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models. In cases where there may be limited or less transparent information provided by the Company's third-party pricing service, fair value may be estimated by the use of secondary pricing services or through the use of non-binding third-party broker quotes.

On a quarterly basis, management reviews the pricing information received from the Company's third-party pricing service. This review process 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 Company's third-party pricing service. Management primarily 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. Investment securities that are

deemed to have been trading in illiquid or inactive markets may require the use of significant unobservable inputs. As of June 30, 2013 and December 31, 2012, management did not make adjustments to prices provided by the third-party pricing service as a result of illiquid or inactive markets. On a quarterly basis, management also reviews a sample of securities priced by the Company's third-party pricing service to review significant assumptions and valuation methodologies used. Based on this review, management determines whether the current placement of the security in the fair value hierarchy is appropriate or whether transfers may be warranted. The Company's third-party pricing service has also established processes for us to submit inquiries regarding quoted prices. Periodically, we will challenge the quoted prices provided by our 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 us. The Company's third-party pricing service may then affirm the original quoted price or may update the evaluation on a going forward basis.

#### Loans Held for Sale

The fair value of the Company's residential mortgage loans held for sale was determined based on quoted prices for similar loans in active markets, and therefore, is classified as a Level 2 measurement.

#### Mortgage Servicing Rights

Mortgage servicing rights do not trade in an active market with readily observable market data. As a result, the Company estimates the fair value of mortgage servicing rights by using a discounted cash flow model to calculate the present value of estimated future net servicing income. The Company stratifies its mortgage servicing portfolio on the basis of loan type. The assumptions used in the discounted cash flow model are those that we believe market participants would use in estimating future net servicing income. Significant assumptions in the valuation of mortgage servicing rights include estimated loan repayment rates, the discount rate, servicing costs, and the timing of cash flows, among other factors. Mortgage servicing rights are classified as Level 3 measurements due to the use of significant unobservable inputs, as well as significant management judgment and estimation.

#### Other Assets

Other assets recorded at fair value on a recurring basis are primarily comprised of investments related to deferred compensation arrangements. Quoted prices for these investments, primarily in mutual funds, are available in active markets. Thus, the Company's investments related to deferred compensation arrangements are classified as Level 1 measurements in the fair value hierarchy.

#### Derivative Financial Instruments

Derivative financial instruments recorded at fair value on a recurring basis are comprised of interest rate lock commitments ("IRLCs"), forward commitments, interest rate swap agreements, and foreign exchange contracts. The fair values of IRLCs are calculated based on the value of the underlying loan, which in turn is based on quoted prices for similar loans in the secondary market. However, this value is adjusted by a factor which considers the likelihood that the loan in a locked position will ultimately close. This factor, the closing ratio, is derived from the Bank's internal data and is adjusted using significant management judgment. As such, IRLCs are classified as Level 3 measurements. Forward commitments are classified as Level 2 measurements as they are primarily based on quoted prices from the secondary market based on the settlement date of the contracts, interpolated or extrapolated, if necessary, to estimate a fair value as of the end of the reporting period. The fair values of interest rate swap agreements are calculated using a discounted cash flow approach and utilize Level 2 observable inputs such as the LIBOR swap curve, effective date, maturity date, notional amount, and stated interest rate. In addition, the Company includes in its fair value calculation a credit factor adjustment which is based primarily on management judgment. Thus, interest rate swap agreements are classified as a Level 3 measurement. The fair values of foreign exchange contracts are calculated using the Bank's multi-currency accounting system which utilizes contract specific information such as currency, maturity date, contractual amount, and strike price, along with market data information such as the spot rates of specific currency and yield curves. Foreign exchange contracts are classified as Level 2 measurements because while they are valued using the Bank's multi-currency accounting system, significant management judgment or estimation is not required.

The Company is exposed to credit risk if borrowers or counterparties fail to perform. The Company seeks to minimize credit risk through credit approvals, limits, monitoring procedures, and collateral requirements. The

Company generally enters into transactions with borrowers and counterparties that carry high quality credit ratings. Credit risk associated with borrowers or counterparties as well as the Company's non-performance risk is factored into the determination of the fair value of derivative financial instruments.

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The table below presents the balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2013 and December 31, 2012:

| (dollars in thousands)                                                               | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets<br>or Liabilities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) | Total       |
|--------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|-------------|
| June 30, 2013                                                                        |                                                                                                 |                                                           |                                                    |             |
| Assets:                                                                              |                                                                                                 |                                                           |                                                    |             |
| Investment Securities Available-for-Sale                                             |                                                                                                 |                                                           |                                                    |             |
| Debt Securities Issued by the U.S. Treasury<br>and Government Agencies               | \$218,962                                                                                       | \$367,064                                                 | \$—                                                | \$586,026   |
| Debt Securities Issued by States and Political<br>Subdivisions                       | —                                                                                               | 561,920                                                   | —                                                  | 561,920     |
| Debt Securities Issued by Corporations                                               | —                                                                                               | 275,289                                                   | —                                                  | 275,289     |
| Mortgage-Backed Securities:                                                          |                                                                                                 |                                                           |                                                    |             |
| Residential - Government Agencies                                                    | —                                                                                               | 815,327                                                   | —                                                  | 815,327     |
| Residential - U.S. Government-Sponsored<br>Enterprises                               | —                                                                                               | 28,478                                                    | —                                                  | 28,478      |
| Commercial - Government Agencies                                                     | —                                                                                               | 548,368                                                   | —                                                  | 548,368     |
| Total Mortgage-Backed Securities                                                     | —                                                                                               | 1,392,173                                                 | —                                                  | 1,392,173   |
| Total Investment Securities Available-for-Sale                                       | 218,962                                                                                         | 2,596,446                                                 | —                                                  | 2,815,408   |
| Loans Held for Sale                                                                  | —                                                                                               | 25,880                                                    | —                                                  | 25,880      |
| Mortgage Servicing Rights                                                            | —                                                                                               | —                                                         | 4,158                                              | 4,158       |
| Other Assets                                                                         | 14,004                                                                                          | —                                                         | —                                                  | 14,004      |
| Derivatives <sup>1</sup>                                                             | —                                                                                               | 4,389                                                     | 25,930                                             | 30,319      |
| Total Assets Measured at Fair Value on a<br>Recurring Basis as of June 30, 2013      | \$232,966                                                                                       | \$2,626,715                                               | \$30,088                                           | \$2,889,769 |
| Liabilities:                                                                         |                                                                                                 |                                                           |                                                    |             |
| Derivatives <sup>1</sup>                                                             | \$—                                                                                             | \$424                                                     | \$26,314                                           | \$26,738    |
| Total Liabilities Measured at Fair Value on a<br>Recurring Basis as of June 30, 2013 | \$—                                                                                             | \$424                                                     | \$26,314                                           | \$26,738    |
| December 31, 2012                                                                    |                                                                                                 |                                                           |                                                    |             |
| Assets:                                                                              |                                                                                                 |                                                           |                                                    |             |
| Investment Securities Available-for-Sale                                             |                                                                                                 |                                                           |                                                    |             |
| Debt Securities Issued by the U.S. Treasury<br>and Government Agencies               | \$470,535                                                                                       | \$399,454                                                 | \$—                                                | \$869,989   |
| Debt Securities Issued by States and Political<br>Subdivisions                       | —                                                                                               | 782,411                                                   | —                                                  | 782,411     |
| Debt Securities Issued by Corporations                                               | —                                                                                               | 84,434                                                    | —                                                  | 84,434      |
| Mortgage-Backed Securities:                                                          |                                                                                                 |                                                           |                                                    |             |
| Residential - Government Agencies                                                    | —                                                                                               | 1,068,660                                                 | —                                                  | 1,068,660   |
| Residential - U.S. Government-Sponsored<br>Enterprises                               | —                                                                                               | 37,298                                                    | —                                                  | 37,298      |
| Commercial - Government Agencies                                                     | —                                                                                               | 524,765                                                   | —                                                  | 524,765     |

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|                                                                                          |           |             |          |             |
|------------------------------------------------------------------------------------------|-----------|-------------|----------|-------------|
| Total Mortgage-Backed Securities                                                         | —         | 1,630,723   | —        | 1,630,723   |
| Total Investment Securities Available-for-Sale                                           | 470,535   | 2,897,022   | —        | 3,367,557   |
| Loans Held for Sale                                                                      | —         | 21,374      | —        | 21,374      |
| Mortgage Servicing Rights                                                                | —         | —           | 4,761    | 4,761       |
| Other Assets                                                                             | 12,566    | —           | —        | 12,566      |
| Derivatives <sup>1</sup>                                                                 | —         | 229         | 42,381   | 42,610      |
| Total Assets Measured at Fair Value on a<br>Recurring Basis as of December 31, 2012      | \$483,101 | \$2,918,625 | \$47,142 | \$3,448,868 |
| Liabilities:                                                                             |           |             |          |             |
| Derivatives <sup>1</sup>                                                                 | \$—       | \$1,185     | \$32,441 | \$33,626    |
| Total Liabilities Measured at Fair Value on a<br>Recurring Basis as of December 31, 2012 | \$—       | \$1,185     | \$32,441 | \$33,626    |

<sup>1</sup> The fair value of each class of derivatives is shown in Note 10 to the Consolidated Financial Statements.

For the three and six months ended June 30, 2013 and 2012, the changes in Level 3 assets and liabilities measured at fair value on a recurring basis were as follows:

| (dollars in thousands)                                     | Mortgage<br>Servicing<br>Rights <sup>1</sup> | Net<br>Derivative<br>Assets and<br>Liabilities <sup>2</sup> | Total     |
|------------------------------------------------------------|----------------------------------------------|-------------------------------------------------------------|-----------|
| <b>Three Months Ended June 30, 2013</b>                    |                                              |                                                             |           |
| Balance as of April 1, 2013                                | \$4,436                                      | \$4,978                                                     | \$9,414   |
| Realized and Unrealized Net Losses:                        |                                              |                                                             |           |
| Included in Net Income                                     | (278                                         | ) (639                                                      | ) (917    |
| Transfers to Loans Held for Sale                           | —                                            | (4,723                                                      | ) (4,723  |
| Balance as of June 30, 2013                                | \$4,158                                      | \$(384)                                                     | \$3,774   |
| Total Unrealized Net Gains (Losses) Included in Net Income | \$30                                         | \$(384)                                                     | \$(354)   |
| Related to Assets Still Held as of June 30, 2013           |                                              |                                                             |           |
| <b>Three Months Ended June 30, 2012</b>                    |                                              |                                                             |           |
| Balance as of April 1, 2012                                | \$6,423                                      | \$2,052                                                     | \$8,475   |
| Realized and Unrealized Net Gains (Losses):                |                                              |                                                             |           |
| Included in Net Income                                     | (964                                         | ) 9,352                                                     | 8,388     |
| Transfers to Loans Held for Sale                           | —                                            | (4,298                                                      | ) (4,298  |
| Balance as of June 30, 2012                                | \$5,459                                      | \$7,106                                                     | \$12,565  |
| Total Unrealized Net Gains (Losses) Included in Net Income | \$(568                                       | ) \$7,106                                                   | \$6,538   |
| Related to Assets Still Held as of June 30, 2012           |                                              |                                                             |           |
| <b>Six Months Ended June 30, 2013</b>                      |                                              |                                                             |           |
| Balance as of January 1, 2013                              | \$4,761                                      | \$9,940                                                     | \$14,701  |
| Realized and Unrealized Net Gains (Losses):                |                                              |                                                             |           |
| Included in Net Income                                     | (603                                         | ) 2,639                                                     | 2,036     |
| Transfers to Loans Held for Sale                           | —                                            | (12,963                                                     | ) (12,963 |
| Balance as of June 30, 2013                                | \$4,158                                      | \$(384)                                                     | \$3,774   |
| Total Unrealized Net Gains (Losses) Included in Net Income | \$64                                         | \$(384)                                                     | \$(320)   |
| Related to Assets Still Held as of June 30, 2013           |                                              |                                                             |           |
| <b>Six Months Ended June 30, 2012</b>                      |                                              |                                                             |           |
| Balance as of January 1, 2012                              | \$7,131                                      | \$2,058                                                     | \$9,189   |
| Realized and Unrealized Net Gains (Losses):                |                                              |                                                             |           |
| Included in Net Income                                     | (1,672                                       | ) 13,071                                                    | 11,399    |
| Transfers to Loans Held for Sale                           | —                                            | (8,023                                                      | ) (8,023  |
| Balance as of June 30, 2012                                | \$5,459                                      | \$7,106                                                     | \$12,565  |
| Total Unrealized Net Gains (Losses) Included in Net Income | \$(881                                       | ) \$7,106                                                   | \$6,225   |
| Related to Assets Still Held as of June 30, 2012           |                                              |                                                             |           |

<sup>1</sup> Realized and unrealized gains and losses related to mortgage servicing rights are reported as a component of mortgage banking income in the Company's consolidated statements of income.

<sup>2</sup> Realized and unrealized gains and losses related to interest rate lock commitments are reported as a component of mortgage banking income in the Company's consolidated statements of income. Realized and unrealized gains and losses related to interest rate swap agreements are reported as a component of other noninterest income in the Company's consolidated statements of income.



For Level 3 assets and liabilities measured at fair value on a recurring or nonrecurring basis as of June 30, 2013 and December 31, 2012, the significant unobservable inputs used in the fair value measurements were as follows:

|                                           |                         | Significant Unobservable Inputs<br>(weighted-average) |                  |   |                     | Fair Value       |                  |
|-------------------------------------------|-------------------------|-------------------------------------------------------|------------------|---|---------------------|------------------|------------------|
| (dollars in thousands)                    | Valuation<br>Technique  | Description                                           | Jun. 30,<br>2013 |   | Dec.<br>31,<br>2012 | Jun. 30,<br>2013 | Dec. 31,<br>2012 |
| Mortgage Servicing Rights                 | Discounted Cash<br>Flow | Constant Prepayment<br>Rate <sup>1</sup>              | 9.88             | % | 12.26               | % \$32,600       | \$27,904         |
|                                           |                         | Discount Rate <sup>2</sup>                            | 6.31             | % | 5.57                | %                |                  |
| Net Derivative Assets and<br>Liabilities: |                         |                                                       |                  |   |                     |                  |                  |
| Interest Rate Lock<br>Commitments         | Pricing Model           | Closing Ratio                                         | 93.22            | % | 88.86               | % \$(199 )       | \$10,188         |
| Interest Rate Swap<br>Agreements          | Discounted Cash<br>Flow | Credit Factor                                         | 0.76             | % | 0.77                | % \$(185 )       | \$(248 )         |

<sup>1</sup> Represents annualized loan repayment rate assumption.

<sup>2</sup> Derived from multiple interest rate scenarios that incorporate a spread to the London Interbank Offered Rate swap curve and market volatilities.

The significant unobservable inputs used in the fair value measurement of the Company's mortgage servicing rights are the weighted-average constant prepayment rate and weighted-average discount rate. Significant increases (decreases) in any of those inputs in isolation could result in a significantly lower (higher) fair value measurement. Although the constant prepayment rate and the discount rate are not directly interrelated, they generally move in opposite directions of each other.

The Company estimates the fair value of mortgage servicing rights by using a discounted cash flow model to calculate the present value of estimated future net servicing income. The Company's Treasury Division enters observable and unobservable inputs into the model to arrive at an estimated fair value. To assess the reasonableness of the fair value measurement, the Treasury Division performs a back-test by applying the model to historical prepayment data. The fair value and constant prepayment rate are also compared to forward-looking estimates to assess reasonableness. The Treasury Division also compares the fair value of the Company's mortgage servicing rights to a value calculated by an independent third-party. Discussions are held with members from the Treasury, Mortgage Banking, and Controllers Divisions, along with the independent third-party to discuss and reconcile the fair value estimates and key assumptions used by the respective parties in arriving at those estimates. A subcommittee of the Company's Asset/Liability Management Committee is responsible for providing oversight over the valuation methodology and key assumptions.

The significant unobservable input used in the fair value measurement of the Company's IRLCs is the closing ratio, which represents the percentage of loans currently in a lock position which management estimates will ultimately close. Generally, the fair value of an IRLC is positive (negative) if the prevailing interest rate is lower (higher) than the IRLC rate. Therefore, an increase in the closing ratio (i.e., higher percentage of loans are estimated to close) will result in the fair value of the IRLC to increase if in a gain position, or decrease if in a loss position. The closing ratio is largely dependent on the loan processing stage that a loan is currently in and the change in prevailing interest rates from the time of the rate lock. The closing ratio is computed by our secondary marketing system using historical data and the ratio is periodically reviewed by the Company's Secondary Marketing Department of the Mortgage Banking Division for reasonableness.

The unobservable input used in the fair value measurement of the Company's interest rate swap agreements is the credit factor. This factor represents the risk that a counterparty is either unable or unwilling to settle a transaction in accordance with the underlying contractual terms. A significant increase (decrease) in the credit factor could result in a significantly lower (higher) fair value measurement. The credit factor is determined by the Treasury Division based on the risk rating assigned to each counterparty in which the Company holds a net asset position. The Company's Credit Policy Committee periodically reviews and approves the Expected Default Frequency of the Economic Capital Model for Credit Risk. The Expected Default Frequency is used as the credit factor for the interest rate swap agreements.

#### Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis

The Company may be required periodically to measure certain assets and liabilities at fair value on a nonrecurring basis in accordance with GAAP. These adjustments to fair value usually result from the application of lower-of-cost-or-fair value accounting or impairment write-downs of individual assets. As of June 30, 2013 and 2012, there were no material adjustments to fair value for the Company's assets and liabilities measured at fair value on a nonrecurring basis in accordance with GAAP.

## Fair Value Option

The Company elected the fair value option for all residential mortgage loans held for sale originated on or after October 1, 2011. This election allows for a more effective offset of the changes in fair values of the loans held for sale and the derivative financial instruments used to economically hedge them without having to apply complex hedge accounting requirements. As noted above, the fair value of the Company's residential mortgage loans held for sale was determined based on quoted prices for similar loans in active markets.

The following table reflects the difference between the aggregate fair value and the aggregate unpaid principal balance of the Company's residential mortgage loans held for sale as of June 30, 2013 and December 31, 2012.

| (dollars in thousands) | Aggregate<br>Fair Value | Aggregate<br>Unpaid Principal | Aggregate Fair Value<br>Less Aggregate<br>Unpaid Principal |
|------------------------|-------------------------|-------------------------------|------------------------------------------------------------|
| June 30, 2013          |                         |                               |                                                            |
| Loans Held for Sale    | \$25,880                | \$ 26,266                     | \$ (386 )                                                  |
| December 31, 2012      |                         |                               |                                                            |
| Loans Held for Sale    | \$21,374                | \$ 20,492                     | \$ 882                                                     |

Changes in the estimated fair value of residential mortgage loans held for sale are reported as a component of mortgage banking income in the Company's consolidated statements of income. For the three and six months ended June 30, 2013 and 2012, the net gains or losses were not material as a result of the change in fair value of the Company's residential mortgage loans held for sale.

#### Financial Instruments Not Recorded at Fair Value on a Recurring Basis

The assumptions used below are expected to approximate those that market participants would use in valuing these financial instruments.

#### Investment Securities Held-to-Maturity

The fair value of the Company's investment securities held-to-maturity was primarily measured using information from a third-party pricing service. Level 1 investment securities are comprised of debt securities issued by the U.S. Treasury as quoted prices were available, unadjusted, for identical securities in active markets. If quoted prices were not available, fair values were estimated primarily by obtaining quoted prices for similar assets in active markets or through the use of pricing models. In cases where there may be limited or less transparent information provided by the Company's third-party pricing service, fair value may be estimated by the use of secondary pricing services or through the use of non-binding third-party broker quotes.

#### Loans

The fair value of the Company's loans was estimated by discounting the expected future cash flows using the current interest rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities. Loans were first segregated by type such as commercial, real estate, and consumer, and were then further segmented into fixed and variable rate and loan quality categories. Expected future cash flows were projected based on contractual cash flows, adjusted for estimated prepayments.

#### Time Deposits

The fair values of the Company's time deposits were estimated using discounted cash flow analyses. The discount rates used were based on rates currently offered for deposits with similar remaining maturities. The fair values of the Company's time deposit liabilities do not take into consideration the value of the Company's long-term relationships with depositors, which may have significant value.

#### Securities Sold Under Agreements to Repurchase

The fair value of the Company's securities sold under agreements to repurchase was calculated using discounted cash flow analyses, applying discount rates currently offered for new agreements with similar remaining maturities and considering the Company's non-performance risk.

#### Long-Term Debt

The fair value of the Company's long-term debt was calculated using a discounted cash flow approach and applying discount rates currently offered for new notes with similar remaining maturities and considering the Company's non-performance risk.

The following presents the carrying amount, fair value, and placement in the fair value hierarchy of the Company's financial instruments as of June 30, 2013 and December 31, 2012. This table excludes financial instruments for which the carrying amount approximates fair value. For short-term financial assets such as cash and cash equivalents, the carrying amount is a reasonable estimate of fair value due to the relatively short time between the origination of the instrument and its expected realization. For non-marketable equity securities such as Federal Home Loan Bank and Federal Reserve Bank stock, the carrying amount is a reasonable estimate of fair value as these securities can only be redeemed or sold at their par value and only to the respective issuing government supported institution or to another member institution. For financial liabilities such as noninterest-bearing demand, interest-bearing demand, and savings deposits, the carrying amount is a reasonable estimate of fair value due to these products having no stated maturity.

|                                                | Carrying    |             | Fair Value Measurements                                                                         |                                                           |                                                    |
|------------------------------------------------|-------------|-------------|-------------------------------------------------------------------------------------------------|-----------------------------------------------------------|----------------------------------------------------|
|                                                |             |             | Quoted Prices<br>in Active<br>Markets for<br>Identical<br>Assets or<br>Liabilities<br>(Level 1) | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| (dollars in thousands)                         | Amount      | Fair Value  |                                                                                                 |                                                           |                                                    |
| June 30, 2013                                  |             |             |                                                                                                 |                                                           |                                                    |
| Financial Instruments - Assets                 |             |             |                                                                                                 |                                                           |                                                    |
| Investment Securities Held-to-Maturity         | \$4,027,829 | \$4,036,197 | \$366,308                                                                                       | \$3,669,889                                               | \$—                                                |
| Loans <sup>1</sup>                             | 5,476,129   | 5,779,297   | —                                                                                               | —                                                         | 5,779,297                                          |
| Financial Instruments - Liabilities            |             |             |                                                                                                 |                                                           |                                                    |
| Time Deposits                                  | 1,350,125   | 1,355,930   | —                                                                                               | 1,355,930                                                 | —                                                  |
| Securities Sold Under Agreements to Repurchase | 866,237     | 950,866     | —                                                                                               | 950,866                                                   | —                                                  |
| Long-Term Debt <sup>2</sup>                    | 165,877     | 167,066     | —                                                                                               | 167,066                                                   | —                                                  |
| December 31, 2012                              |             |             |                                                                                                 |                                                           |                                                    |
| Financial Instruments - Assets                 |             |             |                                                                                                 |                                                           |                                                    |
| Investment Securities Held-to-Maturity         | \$3,595,065 | \$3,687,676 | \$195,366                                                                                       | \$3,492,310                                               | \$—                                                |
| Loans <sup>1</sup>                             | 5,451,935   | 5,846,906   | —                                                                                               | —                                                         | 5,846,906                                          |
| Financial Instruments - Liabilities            |             |             |                                                                                                 |                                                           |                                                    |
| Time Deposits                                  | 1,599,508   | 1,609,506   | —                                                                                               | 1,609,506                                                 | —                                                  |
| Securities Sold Under Agreements to Repurchase | 758,947     | 868,199     | —                                                                                               | 868,199                                                   | —                                                  |
| Long-Term Debt <sup>2</sup>                    | 119,185     | 121,906     | —                                                                                               | 121,906                                                   | —                                                  |

<sup>1</sup> Net of unearned income and the Allowance.

<sup>2</sup> Excludes capitalized lease obligations.

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

### Forward-Looking Statements

This report contains forward-looking statements concerning, among other things, the economic and business environment in our service area and elsewhere, credit quality, and other financial and business matters in future periods. Our forward-looking statements are based on numerous assumptions, any of which could prove to be inaccurate and actual results may differ materially from those projected because of a variety of risks and uncertainties, including, but not limited to: 1) general economic conditions either nationally, internationally, or locally may be different than expected, and particularly, any event that negatively impacts the tourism industry in Hawaii; 2) unanticipated changes in the securities markets, public debt markets, and other capital markets in the U.S. and internationally; 3) the competitive pressure among financial services and products; 4) the impact of legislative and regulatory initiatives, particularly the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"); 5) changes in fiscal and monetary policies of the markets in which we operate; 6) the increased cost of maintaining or the Company's ability to maintain adequate liquidity and capital, based on the requirements adopted by the Basel Committee on Banking Supervision and U.S. regulators; 7) actual or alleged conduct which could harm our reputation; 8) changes in accounting standards; 9) changes in tax laws or regulations or the interpretation of such laws and regulations; 10) changes in our credit quality or risk profile that may increase or decrease the required level of our reserve for credit losses; 11) changes in market interest rates that may affect credit markets and our ability to maintain our net interest margin; 12) the impact of litigation and regulatory investigations of the Company, including costs, expenses, settlements, and judgments; 13) any failure in or breach of our operational systems, information systems or infrastructure, or those of our third party vendors and other service providers; 14) any interruption or breach in security of our information systems resulting in failures or disruptions in customer account management, general ledger processing, and loan or deposit systems; 15) changes to the amount and timing of common stock repurchases; and 16) natural disasters or adverse weather, public unrest, public health and other conditions that impact us and our customers' operations. For a detailed discussion of these and other risks and uncertainties that could cause actual results and events to differ materially from such forward-looking statements, refer to the section entitled "Risk Factors" in Part II of this report and Part I of our Annual Report on Form 10-K for the year ended December 31, 2012, and subsequent periodic and current reports, filed with the U.S. Securities and Exchange Commission (the "SEC"). Words such as "believes," "anticipates," "expects," "intends," "targeted," and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. We do not undertake an obligation to update forward-looking statements to reflect later events or circumstances.

### Overview

Bank of Hawaii Corporation (the "Parent") is a Delaware corporation and a bank holding company headquartered in Honolulu, Hawaii. The Parent's principal and only operating subsidiary is Bank of Hawaii (the "Bank").

The Bank, directly and through its subsidiaries, provides a broad range of financial services to businesses, consumers, and governments in Hawaii, Guam, and other Pacific Islands. References to "we," "our," "us," or the "Company" refer to the Parent and its subsidiaries that are consolidated for financial reporting purposes.

Our business strategy is to use our unique market knowledge, prudent management discipline and brand strength to deliver exceptional value to our stakeholders.

### Hawaii Economy

Hawaii's economy continued to improve during the second quarter of 2013 led by tourism, the State's largest industry. For the first five months of 2013, total visitor arrivals increased by 5.7% and visitor spending increased by 5.1% compared to the same period in 2012. The most significant growth in visitor spending was from U.S. Mainland

visitors. The statewide seasonally-adjusted unemployment rate was at 4.6% in June 2013, compared to 7.6% nationally. For the first six months of 2013, the volume of single-family home sales on Oahu was 11.6% higher compared to the same period in 2012 and the volume of condominium sales on Oahu was 18.8% higher compared to the same period in 2012. Also, the median price of single-family home sales on Oahu was 0.8% higher for the first six months of 2013 compared to same period in 2012, while the median price of condominium sales on Oahu was 6.8% higher compared to the same period in 2012. As of June 30, 2013, months of inventory of single-family homes and condominiums on Oahu remained low at approximately 2.7 months.

## Earnings Summary

Net income for the second quarter of 2013 was \$37.8 million, a decrease of \$3.0 million or 7% compared to the same period in 2012. Diluted earnings per share were \$0.85 for the second quarter of 2013, a decrease of \$0.05 or 6% compared to the same period in 2012. Our lower earnings for the second quarter of 2013 were primarily due to the following:

Net interest income for the second quarter of 2013 was \$87.3 million, a decrease of \$8.0 million or 8% compared to the same period in 2012. Our net interest margin was 2.77% in the second quarter of 2013, a decrease of 21 basis points compared to the same period in 2012. This decrease was primarily due to the reinvestment of investment securities and the repricing of loans at lower yields.

Mortgage banking income for the second quarter of 2013 was \$5.8 million, a decrease of \$1.8 million or 23% compared to the same period in 2012. This decrease was primarily due to lower conforming loan production and margins as a result of higher interest rates in the second quarter of 2013. Should market interest rates continue to increase during the remainder of 2013, we may experience lower mortgage application and production volume, particularly refinancing volume, which may result in lower mortgage banking income.

Salaries and benefits expense for the second quarter of 2013 was \$45.3 million, an increase of \$1.3 million or 3% compared to the same period in 2012. This increase was primarily due to higher separation expense, executive deferred compensation expense, and merit increases.

The impact of these items was partially offset by higher trust and asset management and other noninterest income. Trust and asset management income was \$12.1 million for the second quarter of 2013, an increase of \$0.9 million or 8% compared to the same period in 2012. This increase was primarily due to an increase in agency fees and mutual fund investment management fees. Other noninterest income was \$4.2 million for the second quarter of 2013, an increase of \$1.8 million or 75% compared to the same period in 2012. This increase was primarily due to an increase in the gain on sale of leased assets.

Net income for the first six months of 2013 was \$73.7 million, a decrease of \$10.8 million or 13% compared to the same period in 2012. Diluted earnings per share were \$1.65 for the first six months of 2013, a decrease of \$0.20 or 11% compared to the same period in 2012. Our lower earnings for the first six months of 2013 were primarily due to the following:

Net interest income for the first six months of 2013 was \$175.9 million, a decrease of \$17.4 million or 9% compared to the same period in 2012. Our net interest margin was 2.80% for the first six months of 2013, a decrease of 22 basis points compared to the same period in 2012. This decrease was primarily due to lower yields on loans and investment securities, a result of the low interest rate environment.

Salaries and benefits expense for the first six months of 2013 was \$94.0 million, an increase of \$3.0 million or 3% compared to the same period in 2012. This increase was primarily due to higher separation expense and lower deferred salaries as a result of lower portfolio loan production in the first six months of 2013.

Other noninterest income for the first six months of 2012 was favorably impacted by a \$3.5 million pre-tax gain related to a lessee exercising its early buy-out option on two cargo ship leveraged leases in the first quarter of 2012. This transaction also resulted in a tax gain of \$2.7 million.

The impact of these items was partially offset by a lower provision for credit losses (the "Provision"), net occupancy expense, and net equipment expense. We recorded no Provision for the first six months of 2013 as a result of improvements in our credit quality metrics and an improving Hawaii economy. Net occupancy expense was \$19.3 million for the first six months of 2013, a decrease of \$1.3 million or 6% compared to the same period in 2012. This decrease was primarily due to lower net rental expense as a result of branch closures in 2012. Net equipment expense was \$9.0 million for the first six months of 2013, a decrease of \$1.5 million or 15% compared to the same period in 2012. This decrease was primarily due to the purchase of technology equipment in the first quarter of 2012 as well as lower depreciation expense during the first six months of 2013.

We continued to maintain a strong balance sheet during the second quarter of 2013, with adequate reserves for credit losses, and high levels of liquidity and capital. In particular:

The allowance for loan and lease losses (the "Allowance") was \$124.6 million as of June 30, 2013, a decrease of \$4.3 million or 3% from December 31, 2012. Absent significant deterioration in the economy and assuming continued improvement or stability in credit quality, we may further decrease the level of the Allowance in future periods.

Total deposits were \$11.4 billion as of June 30, 2013, a decrease of \$80.3 million or less than 1% from December 31, 2012. This decrease was primarily due to lower levels of public time deposits as of June 30, 2013.

We continued to invest excess liquidity in high-grade investment securities. As of June 30, 2013, the total carrying value of our investment securities portfolio was \$6.8 billion, a decrease of \$119.4 million or 2% compared to December 31, 2012. During the first six months of 2013, we slightly changed the composition of our investment securities portfolio. We continued to reduce our positions in mortgage-backed securities issued by the Government National Mortgage Corporation ("Ginnie Mae") in an effort to manage extension risk related to our mortgage-backed securities. We re-invested these proceeds, in part, into corporate bonds and state and municipal bond holdings. Total shareholders' equity was \$986.4 million as of June 30, 2013, a decrease of \$35.3 million or 3% from December 31, 2012. This decrease in shareholders' equity was primarily due to a \$47.3 million after-tax decrease in the fair value of our available-for-sale investment securities. Should market interest rates continue to increase during the remainder of 2013, we may experience further reductions in the fair value of our available-for-sale investment securities, which may result in lower levels of capital. We also continued to return capital to our shareholders in the form of share repurchases and dividends. During the first six months of 2013, we repurchased 441,649 shares of our common stock at a total cost of \$21.6 million under our share repurchase program. During the first six months of 2013, we also repurchased 48,460 shares of our common stock from employees and/or directors in connection with stock swaps, shares repurchased for a deferred compensation plan, and income tax withholdings related to the vesting of restricted stock at a total cost of \$2.3 million. We also paid cash dividends of \$40.4 million during the first six months of 2013.

We remain cautious about interest rates, the economy in Hawaii and nationally, as well as the uncertainties related to increased government regulation. In particular, we continue to monitor the pressure on our net interest margin in the current low interest rate environment and the potential additional costs that may be required of us to comply with new and increased government regulations. We intend to continue to focus on controlling expenses and maintaining adequate levels of liquidity, reserves for credit losses, and capital.

Our financial highlights are presented in Table 1.

# Financial Highlights

Table 1

|                                                  | Three Months Ended<br>June 30, |                         | Six Months Ended<br>June 30, |             |
|--------------------------------------------------|--------------------------------|-------------------------|------------------------------|-------------|
| (dollars in thousands, except per share amounts) | 2013                           | 2012                    | 2013                         | 2012        |
| For the Period:                                  |                                |                         |                              |             |
| Operating Results                                |                                |                         |                              |             |
| Net Interest Income                              | \$87,340                       | \$95,381                | \$175,900                    | \$193,329   |
| Provision for Credit Losses                      | —                              | 628                     | —                            | 979         |
| Total Noninterest Income                         | 48,041                         | 46,848                  | 95,819                       | 94,930      |
| Total Noninterest Expense                        | 81,181                         | 80,747                  | 165,568                      | 165,954     |
| Net Income                                       | 37,763                         | 40,747                  | 73,743                       | 84,557      |
| Basic Earnings Per Share                         | 0.85                           | 0.90                    | 1.66                         | 1.86        |
| Diluted Earnings Per Share                       | 0.85                           | 0.90                    | 1.65                         | 1.85        |
| Dividends Declared Per Share                     | 0.45                           | 0.45                    | 0.90                         | 0.90        |
| Performance Ratios                               |                                |                         |                              |             |
| Return on Average Assets                         | 1.12                           | % 1.19                  | % 1.10                       | % 1.24      |
| Return on Average Shareholders' Equity           | 14.64                          | 16.19                   | 14.37                        | 16.73       |
| Efficiency Ratio <sup>1</sup>                    | 59.96                          | 56.77                   | 60.93                        | 57.57       |
| Net Interest Margin <sup>2</sup>                 | 2.77                           | 2.98                    | 2.80                         | 3.02        |
| Dividend Payout Ratio <sup>3</sup>               | 52.94                          | 50.00                   | 54.22                        | 48.39       |
| Average Shareholders' Equity to Average Assets   | 7.62                           | 7.36                    | 7.63                         | 7.41        |
| Average Balances                                 |                                |                         |                              |             |
| Average Loans and Leases                         | \$5,781,898                    | \$5,641,588             | \$5,792,641                  | \$5,602,473 |
| Average Assets                                   | 13,572,329                     | 13,750,488              | 13,564,885                   | 13,715,859  |
| Average Deposits                                 | 11,244,600                     | 10,622,420              | 11,265,924                   | 10,526,317  |
| Average Shareholders' Equity                     | 1,034,366                      | 1,012,182               | 1,034,603                    | 1,016,425   |
| Market Price Per Share of Common Stock           |                                |                         |                              |             |
| Closing                                          | \$50.32                        | \$45.95                 | \$50.32                      | \$45.95     |
| High                                             | 52.17                          | 49.99                   | 52.17                        | 49.99       |
| Low                                              | 46.04                          | 44.02                   | 44.88                        | 44.02       |
|                                                  | June 30,<br>2013               | December<br>31,<br>2012 |                              |             |
| As of Period End:                                |                                |                         |                              |             |
| Balance Sheet Totals                             |                                |                         |                              |             |
| Loans and Leases                                 | \$5,859,152                    | \$5,854,521             |                              |             |
| Total Assets                                     | 13,733,418                     | 13,728,372              |                              |             |
| Total Deposits                                   | 11,449,198                     | 11,529,482              |                              |             |
| Long-Term Debt                                   | 174,727                        | 128,055                 |                              |             |
| Total Shareholders' Equity                       | 986,368                        | 1,021,665               |                              |             |
| Asset Quality                                    |                                |                         |                              |             |
| Allowance for Loan and Lease Losses              | \$124,575                      | \$128,857               |                              |             |
| Non-Performing Assets                            | 36,431                         | 37,083                  |                              |             |

Financial Ratios

|                                                             |       |   |       |   |
|-------------------------------------------------------------|-------|---|-------|---|
| Allowance to Loans and Leases Outstanding                   | 2.13  | % | 2.20  | % |
| Tier 1 Capital Ratio                                        | 15.53 |   | 16.13 |   |
| Total Capital Ratio                                         | 16.79 |   | 17.39 |   |
| Tier 1 Leverage Ratio                                       | 6.95  |   | 6.83  |   |
| Total Shareholders' Equity to Total Assets                  | 7.18  |   | 7.44  |   |
| Tangible Common Equity to Tangible Assets <sup>4</sup>      | 6.97  |   | 7.23  |   |
| Tangible Common Equity to Risk-Weighted Assets <sup>4</sup> | 15.65 |   | 17.24 |   |

Non-Financial Data

|                                |       |       |
|--------------------------------|-------|-------|
| Full-Time Equivalent Employees | 2,227 | 2,276 |
| Branches and Offices           | 75    | 76    |
| ATMs                           | 486   | 494   |

<sup>1</sup> Efficiency ratio is defined as noninterest expense divided by total revenue (net interest income and total noninterest income).

<sup>2</sup> Net interest margin is defined as net interest income, on a taxable-equivalent basis, as a percentage of average earning assets.

<sup>3</sup> Dividend payout ratio is defined as dividends declared per share divided by basic earnings per share.

<sup>4</sup> Tangible common equity to tangible assets and tangible common equity to risk-weighted assets are Non-GAAP financial measures. See the "Use of Non-GAAP Financial Measures" section below.

# Use of Non-GAAP Financial Measures

The ratios “tangible common equity to tangible assets” and “tangible common equity to risk-weighted assets” are Non-GAAP financial measures. The Company believes these measurements are useful for investors, regulators, management and others to evaluate capital adequacy relative to other financial institutions. Although these Non-GAAP financial measures are frequently used by stakeholders 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. Table 2 provides a reconciliation of these Non-GAAP financial measures with the most comparable financial measures defined by GAAP.

| GAAP to Non-GAAP Reconciliation                                                        | Table 2          |   |                  |   |
|----------------------------------------------------------------------------------------|------------------|---|------------------|---|
| (dollars in thousands)                                                                 | June 30,         |   | December 31,     |   |
|                                                                                        | 2013             |   | 2012             |   |
| Total Shareholders' Equity                                                             | \$986,368        |   | \$1,021,665      |   |
| Less: Goodwill                                                                         | 31,517           |   | 31,517           |   |
| Intangible Assets                                                                      | 8                |   | 33               |   |
| Tangible Common Equity                                                                 | \$954,843        |   | \$990,115        |   |
| <br>Total Assets                                                                       | <br>\$13,733,418 |   | <br>\$13,728,372 |   |
| Less: Goodwill                                                                         | 31,517           |   | 31,517           |   |
| Intangible Assets                                                                      | 8                |   | 33               |   |
| Tangible Assets                                                                        | \$13,701,893     |   | \$13,696,822     |   |
| Risk-Weighted Assets, determined in accordance with prescribed regulatory requirements | \$6,099,770      |   | \$5,744,722      |   |
| <br>Total Shareholders' Equity to Total Assets                                         | <br>7.18         | % | <br>7.44         | % |
| Tangible Common Equity to Tangible Assets (Non-GAAP)                                   | 6.97             | % | 7.23             | % |
| <br>Tier 1 Capital Ratio                                                               | <br>15.53        | % | <br>16.13        | % |
| Tangible Common Equity to Risk-Weighted Assets (Non-GAAP)                              | 15.65            | % | 17.24            | % |

## Analysis of Statements of Income

Average balances, related income and expenses, and resulting yields and rates are presented in Table 3. An analysis of the change in net interest income, on a taxable-equivalent basis, is presented in Table 4.

## Average Balances and Interest Rates - Taxable-Equivalent Basis

Table 3

|                                              | Three Months Ended<br>June 30, 2013 |                   |                | Three Months Ended<br>June 30, 2012 |                   |                | Six Months Ended<br>June 30, 2013 |                   |                | Six Months Ended<br>June 30, 2012 |                   |                |
|----------------------------------------------|-------------------------------------|-------------------|----------------|-------------------------------------|-------------------|----------------|-----------------------------------|-------------------|----------------|-----------------------------------|-------------------|----------------|
| (dollars in millions)                        | Average<br>Balance                  | Income<br>Expense | Yield/<br>Rate | Average<br>Balance                  | Income<br>Expense | Yield/<br>Rate | Average<br>Balance                | Income<br>Expense | Yield/<br>Rate | Average<br>Balance                | Income<br>Expense | Yield/<br>Rate |
| <b>Earning Assets</b>                        |                                     |                   |                |                                     |                   |                |                                   |                   |                |                                   |                   |                |
| Interest-Bearing Deposits                    | \$4.5                               | \$—               | 0.06 %         | \$3.0                               | \$—               | 0.12 %         | \$4.2                             | \$—               | 0.18 %         | \$3.1                             | \$—               | 0.12 %         |
| Funds Sold                                   | 168.3                               | 0.1               | 0.18           | 237.8                               | 0.1               | 0.20           | 162.4                             | 0.1               | 0.16           | 250.1                             | 0.2               | 0.18           |
| <b>Investment Securities</b>                 |                                     |                   |                |                                     |                   |                |                                   |                   |                |                                   |                   |                |
| Available-for-Sale                           | 3,212.2                             | 17.4              | 2.17           | 3,410.4                             | 19.4              | 2.27           | 3,266.9                           | 35.6              | 2.18           | 3,431.0                           | 39.0              | 2.27           |
| Held-to-Maturity                             | 3,714.3                             | 19.2              | 2.07           | 3,788.9                             | 25.1              | 2.65           | 3,646.6                           | 39.1              | 2.14           | 3,763.1                           | 51.5              | 2.65           |
| Loans Held for Sale                          | 22.9                                | 0.2               | 3.87           | 12.1                                | 0.1               | 4.22           | 20.6                              | 0.4               | 3.90           | 12.0                              | 0.3               | 4.22           |
| <b>Loans and Leases <sup>1</sup></b>         |                                     |                   |                |                                     |                   |                |                                   |                   |                |                                   |                   |                |
| Commercial and Industrial                    | 855.5                               | 7.8               | 3.65           | 786.3                               | 7.7               | 3.93           | 839.3                             | 15.4              | 3.70           | 796.1                             | 15.8              | 3.93           |
| Commercial Mortgage                          | 1,114.8                             | 11.3              | 4.08           | 953.5                               | 10.4              | 4.40           | 1,104.1                           | 22.4              | 4.09           | 947.6                             | 21.0              | 4.40           |
| Construction                                 | 107.5                               | 1.2               | 4.61           | 99.7                                | 1.3               | 5.07           | 111.5                             | 2.7               | 4.83           | 101.6                             | 2.6               | 5.07           |
| Commercial Lease Financing                   | 265.2                               | 1.6               | 2.36           | 284.5                               | 1.7               | 2.36           | 268.9                             | 3.2               | 2.38           | 289.4                             | 3.4               | 2.36           |
| Residential Mortgage                         | 2,252.1                             | 25.5              | 4.53           | 2,371.7                             | 27.9              | 4.71           | 2,281.7                           | 51.5              | 4.51           | 2,318.0                           | 55.7              | 4.71           |
| Home Equity                                  | 752.9                               | 7.8               | 4.15           | 772.3                               | 8.4               | 4.36           | 760.4                             | 15.7              | 4.15           | 775.6                             | 16.9              | 4.36           |
| Automobile                                   | 225.0                               | 3.1               | 5.51           | 193.7                               | 2.9               | 6.03           | 219.5                             | 6.0               | 5.56           | 193.4                             | 5.9               | 6.03           |
| Other <sup>2</sup>                           | 208.9                               | 4.3               | 8.22           | 179.9                               | 3.6               | 8.12           | 207.2                             | 8.5               | 8.28           | 180.8                             | 7.3               | 8.12           |
| <b>Total Loans and Leases</b>                | <b>5,781.9</b>                      | <b>62.6</b>       | <b>4.34</b>    | <b>5,641.6</b>                      | <b>63.9</b>       | <b>4.54</b>    | <b>5,792.6</b>                    | <b>125.4</b>      | <b>4.35</b>    | <b>5,602.5</b>                    | <b>128.6</b>      | <b>4.54</b>    |
| Other                                        | 78.6                                | 0.3               | 1.45           | 80.0                                | 0.3               | 1.41           | 78.8                              | 0.5               | 1.44           | 80.0                              | 0.6               | 1.41           |
| <b>Total Earning Assets <sup>3</sup></b>     | <b>12,982.7</b>                     | <b>99.8</b>       | <b>3.08</b>    | <b>13,173.8</b>                     | <b>108.9</b>      | <b>3.31</b>    | <b>12,972.1</b>                   | <b>201.1</b>      | <b>3.11</b>    | <b>13,141.8</b>                   | <b>220.2</b>      | <b>3.31</b>    |
| <b>Cash and Noninterest-Bearing Deposits</b> | <b>136.8</b>                        |                   |                | <b>131.7</b>                        |                   |                | <b>139.4</b>                      |                   |                | <b>134.5</b>                      |                   |                |
| Other Assets                                 | 452.8                               |                   |                | 445.0                               |                   |                | 453.4                             |                   |                | 439.6                             |                   |                |
| <b>Total Assets</b>                          | <b>\$13,572.3</b>                   |                   |                | <b>\$13,750.5</b>                   |                   |                | <b>\$13,564.9</b>                 |                   |                | <b>\$13,715.9</b>                 |                   |                |

|                                            |            |        |      |   |            |        |      |   |            |         |      |   |            |         |   |
|--------------------------------------------|------------|--------|------|---|------------|--------|------|---|------------|---------|------|---|------------|---------|---|
| Interest-Bearing Liabilities               |            |        |      |   |            |        |      |   |            |         |      |   |            |         |   |
| Interest-Bearing Deposits                  |            |        |      |   |            |        |      |   |            |         |      |   |            |         |   |
| Demand                                     | \$2,106.0  | \$0.2  | 0.03 | % | \$1,906.1  | \$0.1  | 0.03 | % | \$2,083.4  | \$0.3   | 0.03 | % | \$1,886.6  | \$0.2   | 0 |
| Savings                                    | 4,451.1    | 1.0    | 0.09 |   | 4,444.5    | 1.1    | 0.10 |   | 4,429.9    | 1.9     | 0.09 |   | 4,441.8    | 2.4     | 0 |
| Time                                       | 1,381.4    | 1.4    | 0.42 |   | 1,253.9    | 2.0    | 0.63 |   | 1,446.8    | 3.0     | 0.42 |   | 1,257.0    | 4.1     | 0 |
| Total                                      |            |        |      |   |            |        |      |   |            |         |      |   |            |         |   |
| Interest-Bearing Deposits                  | 7,938.5    | 2.6    | 0.13 |   | 7,604.5    | 3.2    | 0.17 |   | 7,960.1    | 5.2     | 0.13 |   | 7,585.4    | 6.7     | 0 |
| Short-Term Borrowings                      | 29.4       | —      | 0.12 |   | 15.0       | —      | 0.14 |   | 43.7       | —       | 0.14 |   | 15.3       | —       | 0 |
| Securities Sold                            |            |        |      |   |            |        |      |   |            |         |      |   |            |         |   |
| Under Agreements to Repurchase             | 800.1      | 6.7    | 3.34 |   | 1,808.5    | 7.3    | 1.59 |   | 778.2      | 13.8    | 3.52 |   | 1,862.3    | 14.6    | 1 |
| Long-Term Debt                             | 177.3      | 0.7    | 1.52 |   | 30.6       | 0.5    | 6.51 |   | 167.3      | 1.3     | 1.57 |   | 30.7       | 1.0     | 6 |
| Total                                      |            |        |      |   |            |        |      |   |            |         |      |   |            |         |   |
| Interest-Bearing Liabilities               | 8,945.3    | 10.0   | 0.44 |   | 9,458.6    | 11.0   | 0.46 |   | 8,949.3    | 20.3    | 0.45 |   | 9,493.7    | 22.3    | 0 |
| Net Interest Income                        |            | \$89.8 |      |   |            | \$97.9 |      |   |            | \$180.8 |      |   |            | \$197.9 |   |
| Interest Rate Spread                       |            |        | 2.64 | % |            |        | 2.85 | % |            |         | 2.66 | % |            |         | 2 |
| Net Interest Margin                        |            |        | 2.77 | % |            |        | 2.98 | % |            |         | 2.80 | % |            |         | 3 |
| Noninterest-Bearing Demand Deposits        | 3,306.1    |        |      |   | 3,017.9    |        |      |   | 3,305.8    |         |      |   | 2,940.9    |         |   |
| Other Liabilities                          | 286.5      |        |      |   | 261.8      |        |      |   | 275.2      |         |      |   | 264.9      |         |   |
| Shareholders' Equity                       | 1,034.4    |        |      |   | 1,012.2    |        |      |   | 1,034.6    |         |      |   | 1,016.4    |         |   |
| Total Liabilities and Shareholders' Equity | \$13,572.3 |        |      |   | \$13,750.5 |        |      |   | \$13,564.9 |         |      |   | \$13,715.9 |         |   |

<sup>1</sup> 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.

<sup>2</sup> Comprised of other consumer revolving credit, installment, and consumer lease financing.

Interest income includes taxable-equivalent basis adjustments, based upon a federal statutory tax rate of 35%, of \$2,490,000 and \$2,481,000 for the three months ended June 30, 2013 and 2012, respectively, and \$4,901,000 and \$4,551,000 for the six months ended June 30, 2013 and 2012, respectively.

## Analysis of Change in Net Interest Income - Taxable-Equivalent Basis

Table 4

|                                                |  | Six Months Ended June 30, 2013<br>Compared to June 30, 2012 |                   |           |
|------------------------------------------------|--|-------------------------------------------------------------|-------------------|-----------|
| (dollars in millions)                          |  | Volume <sup>1</sup>                                         | Rate <sup>1</sup> | Total     |
| Change in Interest Income:                     |  |                                                             |                   |           |
| Funds Sold                                     |  | \$(0.1 )                                                    | \$—               | \$(0.1 )  |
| Investment Securities                          |  |                                                             |                   |           |
| Available-for-Sale                             |  | (1.8 )                                                      | (1.6 )            | (3.4 )    |
| Held-to-Maturity                               |  | (1.5 )                                                      | (10.9 )           | (12.4 )   |
| Loans Held for Sale                            |  | 0.1                                                         | —                 | 0.1       |
| Loans and Leases                               |  |                                                             |                   |           |
| Commercial and Industrial                      |  | 0.8                                                         | (1.2 )            | (0.4 )    |
| Commercial Mortgage                            |  | 3.2                                                         | (1.8 )            | 1.4       |
| Construction                                   |  | 0.3                                                         | (0.2 )            | 0.1       |
| Commercial Lease Financing                     |  | (0.3 )                                                      | 0.1               | (0.2 )    |
| Residential Mortgage                           |  | (0.9 )                                                      | (3.3 )            | (4.2 )    |
| Home Equity                                    |  | (0.3 )                                                      | (0.9 )            | (1.2 )    |
| Automobile                                     |  | 0.7                                                         | (0.6 )            | 0.1       |
| Other <sup>2</sup>                             |  | 1.1                                                         | 0.1               | 1.2       |
| Total Loans and Leases                         |  | 4.6                                                         | (7.8 )            | (3.2 )    |
| Other                                          |  | (0.1 )                                                      | —                 | (0.1 )    |
| Total Change in Interest Income                |  | 1.2                                                         | (20.3 )           | (19.1 )   |
| Change in Interest Expense:                    |  |                                                             |                   |           |
| Interest-Bearing Deposits                      |  |                                                             |                   |           |
| Demand                                         |  | —                                                           | 0.1               | 0.1       |
| Savings                                        |  | —                                                           | (0.5 )            | (0.5 )    |
| Time                                           |  | 0.5                                                         | (1.6 )            | (1.1 )    |
| Total Interest-Bearing Deposits                |  | 0.5                                                         | (2.0 )            | (1.5 )    |
| Securities Sold Under Agreements to Repurchase |  | (11.8 )                                                     | 11.0              | (0.8 )    |
| Long-Term Debt                                 |  | 1.5                                                         | (1.2 )            | 0.3       |
| Total Change in Interest Expense               |  | (9.8 )                                                      | 7.8               | (2.0 )    |
| Change in Net Interest Income                  |  | \$11.0                                                      | \$(28.1 )         | \$(17.1 ) |

<sup>1</sup> 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.

<sup>2</sup> Comprised of other consumer revolving credit, installment, and consumer lease financing.

## Net Interest Income

Net interest income is affected by the size and mix of our balance sheet components as well as the spread between interest earned on assets and interest paid on liabilities. Net interest margin is defined as net interest income, on a taxable-equivalent basis, as a percentage of average earning assets.

Net interest income was \$87.3 million in the second quarter of 2013, a decrease of \$8.0 million or 8% compared to the same period in 2012. On a taxable-equivalent basis, net interest income was \$89.8 million in the second quarter of 2013, a decrease of \$8.0 million or 8% compared to the same period in 2012. The net interest margin was 2.77% in the second quarter of 2013, a decrease of 21 basis points compared to the same period in 2012. Net interest income

was \$175.9 million for the first six months of 2013, a decrease of \$17.4 million or 9% compared to the same period in 2012. On a taxable-equivalent basis, net interest income was \$180.8 million for the first six months of 2013, a decrease of \$17.1 million or 9% compared to the same period in 2012. The net interest margin was 2.80% for the first six months of 2013, a decrease of 22 basis points compared to the same period in 2012. The lower margins in 2013 were primarily due to the reinvestment of investment securities and the re-pricing of loans at lower yields. Interest rates increased significantly in the latter part of the second quarter of 2013. To the extent this represents a trend, it is possible that the negative pressure on margins may abate in the future.

Yields on our earning assets decreased by 23 basis points in the second quarter of 2013 and by 25 basis points for the first six months of 2013 compared to the same periods in 2012, reflective of lower yields on investment securities and loans. Yields on our investment securities portfolio decreased by 35 basis points in the second quarter of 2013 and by 36 basis points for the

first six months of 2013 compared to the same periods in 2012, reflective of the run-off of higher yielding securities with proceeds, in part, being invested in lower yielding securities. Yields on our loans and leases decreased by 20 basis points in the second quarter of 2013 and by 25 basis points for the first six months of 2013 compared to the same periods in 2012, with lower yields in nearly every category of loans and leases, as a result of the current low interest rate environment. Partially offsetting the lower yields on our earning assets were lower funding costs, primarily due to lower rates paid on our interest-bearing deposits, reflective of the re-pricing of our deposits at lower interest rates. Rates paid on our time deposits decreased by 21 basis points in the second quarter of 2013 and by 22 basis points for the first six months of 2013 compared to the same periods in 2012. Rates paid on our securities sold under agreements to repurchase increased by 175 basis points in the second quarter of 2013 and by 197 basis points for the first six months of 2013 compared to the same periods in 2012. This increase was primarily due to local government entities transferring much of their funds previously invested in short-term (and therefore low-yielding) repurchase agreements into time deposits, leaving the balance of our repurchase agreements consisting mainly of those with private entities. These agreements with private entities have longer terms at relatively higher interest rates.

Average balances of our earning assets decreased by \$191.2 million or 1% in the second quarter of 2013 compared to the same period in 2012, primarily due to a \$272.8 million decrease in the average balance of our investment securities portfolio. During the second quarter of 2013, we continued to slightly change the composition of our investment securities portfolio. We decreased our holdings in mortgage-backed securities issued by the Government National Mortgage Association (“Ginnie Mae”) in an effort to manage extension risk related to our mortgage-backed securities and reduced our holdings in U.S. Treasury notes. We re-invested these proceeds, in part, into corporate bonds and state and municipal bond holdings. Average balances of our mortgage-backed securities issued by Ginnie Mae decreased by \$217.4 million and average balances of our U.S. Treasury notes decreased by \$328.5 million in the second quarter of 2013 compared to the same period in 2012. Average balances of our corporate bonds increased by \$150.3 million and our state and municipal bond holdings increased by \$156.6 million in the second quarter of 2013 compared to the same period in 2012. Partially offsetting the decrease in the average balance of our investment securities portfolio was a \$161.2 million increase in our commercial mortgage loan portfolio primarily due to increased demand from new and existing customers and a \$69.2 million increase in our commercial and industrial loan portfolio due to an increase in corporate demand for funding, reflective of an improving Hawaii economy. The increase in the average balances of these loan categories was partially offset by a \$119.6 million decrease in our residential mortgage loan portfolio primarily due to lower loan originations, the result of higher interest rates and continued paydowns in the second quarter of 2013.

Average balances of our earning assets decreased by \$169.6 million or 1% in the first six months of 2013 compared to the same period in 2012, primarily due to a \$280.6 million decrease in the average balance of our investment securities portfolio. As noted above, in 2013 we continued to decrease our holdings in mortgage-backed securities issued by Ginnie Mae, reduced our holdings in U.S. Treasury notes, and increased our corporate bond and state and municipal bond holdings. Average balances of our mortgage-backed securities issued by Ginnie Mae decreased by \$205.0 million and average balances of our U.S. Treasury notes decreased by \$328.1 million in the first six months of 2013 compared to the same period in 2012. Average balances of our corporate bonds increased by \$81.9 million and our state and municipal bond holdings increased by \$208.8 million in the first six months of 2013 compared to the same period in 2012. Partially offsetting the decrease in the average balance of our investment securities portfolio was a \$156.6 million increase in our commercial mortgage loan portfolio primarily due to increased demand from new and existing customers.

Average balances of our interest-bearing liabilities decreased by \$513.3 million or 5% in the second quarter of 2013 and by \$544.4 million or 6% for the first six months of 2013 compared to the same periods in 2012 due to lower balances of securities sold under agreements to repurchase with local government entities, a portion of which was transferred into time deposits.

## Provision for Credit Losses

The Provision reflects our judgment of the expense or benefit necessary to achieve the appropriate amount of the Allowance. We maintain the Allowance at levels adequate to cover our estimate of probable credit losses as of the end of the reporting period. The Allowance is determined through detailed quarterly analyses of the loan and lease portfolio. The Allowance is based on our loss experience and changes in the economic environment, as well as an ongoing assessment of credit quality. Additional factors that are considered in determining the amount of the Allowance are the level of net charge-offs, non-performing assets, risk rating migration, as well as changes in our portfolio size and composition. We recorded no Provision in the first six months of 2013 and recorded a Provision of \$0.6 million in the second quarter of 2012 and a Provision of \$1.0 million for the first six months of 2012. Our decision not to record a Provision in the first six months of 2013 was reflective of continued improvements in our credit quality metrics and an improving Hawaii economy. For further discussion on the Allowance, see the “Corporate Risk Profile - Reserve for Credit Losses” section in MD&A.

## Noninterest Income

Noninterest income increased by \$1.2 million or 3% in the second quarter of 2013 and by \$0.9 million or 1% for the first six months of 2013 compared to the same periods in 2012.

Table 5 presents the components of noninterest income.

| (dollars in thousands)                    | Three Months Ended June 30, |          |          | Six Months Ended June 30, |          |         | Table 5 |
|-------------------------------------------|-----------------------------|----------|----------|---------------------------|----------|---------|---------|
|                                           | 2013                        | 2012     | Change   | 2013                      | 2012     | Change  |         |
| Trust and Asset Management                | \$12,089                    | \$11,195 | \$894    | \$23,975                  | \$22,113 | \$1,862 |         |
| Mortgage Banking                          | 5,820                       | 7,581    | (1,761 ) | 12,231                    | 12,631   | (400 )  |         |
| Service Charges on Deposit Accounts       | 9,112                       | 9,225    | (113 )   | 18,413                    | 18,816   | (403 )  |         |
| Fees, Exchange, and Other Service Charges | 13,133                      | 12,326   | 807      | 25,067                    | 24,725   | 342     |         |
| Investment Securities Losses, Net         | —                           | —        | —        | —                         | (90 )    | 90      |         |
| Insurance                                 | 2,393                       | 2,399    | (6 )     | 4,718                     | 4,677    | 41      |         |
| Bank-Owned Life Insurance                 | 1,335                       | 1,739    | (404 )   | 2,632                     | 3,220    | (588 )  |         |
| Other Income                              | 4,159                       | 2,383    | 1,776    | 8,783                     | 8,838    | (55 )   |         |
| Total Noninterest Income                  | \$48,041                    | \$46,848 | \$1,193  | \$95,819                  | \$94,930 | \$889   |         |

Trust and asset management income is comprised of fees earned from the management and administration of trusts and other customer assets. These fees are largely based upon the market value of the assets that we manage and the fee rate charged to customers. Total trust assets under administration were \$10.0 billion as of June 30, 2013, \$10.1 billion as of December 31, 2012, and \$9.9 billion as of June 30, 2012. Trust and asset management income increased by \$0.9 million or 8% in the second quarter of 2013 compared to the same period in 2012. This increase was partially due to a \$0.4 million increase in agency fees mainly due to higher market values of assets under management. In addition, mutual fund investment management fees increased by \$0.2 million. Trust and asset management income increased by \$1.9 million or 8% for the first six months of 2013 compared to the same period in 2012. This increase was partially due to a \$0.7 million increase in agency fees mainly due to higher market values of assets under management. In addition, mutual fund investment management fees increased by \$0.4 million and special service fees increased by \$0.3 million.

Mortgage banking income is highly influenced by mortgage interest rates and the housing market. Mortgage banking income decreased by \$1.8 million or 23% in the second quarter of 2013 compared to the same period in 2012. This decrease was primarily due to lower conforming loan volume and margins resulting from higher interest rates. Mortgage banking income decreased by \$0.4 million or 3% for the first six months of 2013 compared to the same period in 2012. This decrease was also due to lower conforming loan volume and margins resulting from higher interest rates, partially offset by lower changes in the fair value of our mortgage servicing rights, also the result of higher interest rates. Should market interest rates continue to increase during the remainder of 2013, we may experience lower mortgage application and production volume, particularly refinancing volume, which may result in lower mortgage banking income.

Service charges on deposit accounts decreased by \$0.1 million or 1% in the second quarter of 2013 and by \$0.4 million or 2% for the first six months of 2013 compared to the same periods in 2012. The decrease during the first six months of 2013 was primarily due to a \$0.2 million decline in account analysis fees due to higher investable balances resulting in larger earnings credit rates granted to our customers. In addition, overdraft fees also decreased by \$0.2 million during the first six months of 2013 mainly due to higher deposit balances.

Fees, exchange, and other service charges are primarily comprised of debit card income, fees from ATMs, merchant service activity, and other loan fees and service charges. Fees, exchange, and other service charges increased by \$0.8 million or 7% in the second quarter of 2013 compared to the same period in 2012. This increase was primarily due to a \$0.9 million increase in other loan fees, primarily prepayment penalty fees and syndication and administration fees. Fees, exchange, and other service charges increased by \$0.3 million or 1% for the first six months of 2013 compared to the same period in 2012. This increase was primarily due to a \$0.7 million increase in other loan fees mainly due to the prepayment penalty fees and syndication and administration fees mentioned above. In addition, we received \$0.2 million in fees from our new consumer credit cards. Partially offsetting the increase was a \$0.2 million decrease in both debit card income and ATM income.

Bank-owned life insurance decreased by \$0.4 million or 23% in the second quarter of 2013 and by \$0.6 million or 18% for the first six months of 2013 compared to the same periods in 2012. These decreases were primarily due to a persistency bonus received from our insurance carrier in the second quarter of 2012, combined with lower yields received in the current year.

Other noninterest income increased by \$1.8 million or 75% in the second quarter of 2013 compared to the same period in 2012. This increase was primarily due to a \$0.6 million increase in the fair value of assets related to deferred compensation plans. Gain on sale of leased assets increased by \$0.4 million primarily related to the sale of two equipment leases. In addition, we recognized an additional \$0.2 million in fees related to our customer derivative program. Other noninterest income remained relatively unchanged during the first six months of 2013 compared to the same period in 2012. Gain on sale of leased assets decreased by \$1.3 million. This decrease was primarily due to a lessee exercising its early buy-out option on two cargo ship leveraged leases which resulted in a pre-tax gain of \$3.5 million in the first quarter of 2012, partially offset by a \$1.0 million pre-tax loss related to the sale and termination of an aircraft lease which also occurred in the first quarter of 2012. This decrease was partially offset by \$1.0 million in gains related to the sale of four equipment leases in the first six months of 2013. Offsetting the decrease on gain on sale of leased assets were increases in several miscellaneous income categories including shareholder servicing fees (\$0.3 million), terminal and safe deposit rentals (\$0.3 million), and customer derivative program (\$0.2 million).

### Noninterest Expense

Noninterest expense increased by \$0.4 million or 1% in the second quarter of 2013 and decreased by \$0.4 million or less than 1% for the first six months of 2013 compared to the same periods in 2012.

Table 6 presents the components of noninterest expense.

| Noninterest Expense                           |                             |          | Table 6 |                           |           |         |
|-----------------------------------------------|-----------------------------|----------|---------|---------------------------|-----------|---------|
| (dollars in thousands)                        | Three Months Ended June 30, |          |         | Six Months Ended June 30, |           |         |
|                                               | 2013                        | 2012     | Change  | 2013                      | 2012      | Change  |
| Salaries                                      | \$28,690                    | \$27,831 | \$859   | \$57,768                  | \$56,518  | \$1,250 |
| Incentive Compensation                        | 3,861                       | 4,132    | (271)   | 7,645                     | 8,186     | (541)   |
| Share-Based Compensation                      | 1,305                       | 1,758    | (453)   | 2,441                     | 3,443     | (1,002) |
| Commission Expense                            | 1,983                       | 1,754    | 229     | 3,764                     | 3,290     | 474     |
| Retirement and Other Benefits                 | 3,594                       | 3,481    | 113     | 7,962                     | 7,871     | 91      |
| Payroll Taxes                                 | 2,576                       | 2,437    | 139     | 6,816                     | 6,255     | 561     |
| Medical, Dental, and Life Insurance           | 2,468                       | 2,239    | 229     | 5,281                     | 4,676     | 605     |
| Separation Expense                            | 864                         | 405      | 459     | 2,339                     | 822       | 1,517   |
| Total Salaries and Benefits                   | 45,341                      | 44,037   | 1,304   | 94,016                    | 91,061    | 2,955   |
| Net Occupancy                                 | 9,661                       | 10,058   | (397)   | 19,296                    | 20,574    | (1,278) |
| Net Equipment                                 | 4,380                       | 4,669    | (289)   | 8,957                     | 10,495    | (1,538) |
| Data Processing                               | 3,050                       | 3,160    | (110)   | 6,316                     | 6,747     | (431)   |
| Professional Fees                             | 2,391                       | 2,386    | 5       | 4,617                     | 4,518     | 99      |
| FDIC Insurance                                | 1,949                       | 2,088    | (139)   | 3,898                     | 4,159     | (261)   |
| Other Expense:                                |                             |          |         |                           |           |         |
| Delivery and Postage Services                 | 2,106                       | 2,132    | (26)    | 4,265                     | 4,225     | 40      |
| Mileage Program Travel                        | 1,560                       | 1,730    | (170)   | 3,261                     | 3,351     | (90)    |
| Merchant Transaction and Card Processing Fees | 1,189                       | 1,378    | (189)   | 2,352                     | 2,800     | (448)   |
| Advertising                                   | 1,281                       | 1,036    | 245     | 2,625                     | 2,260     | 365     |
| Other                                         | 8,273                       | 8,073    | 200     | 15,965                    | 15,764    | 201     |
| Total Other Expense                           | 14,409                      | 14,349   | 60      | 28,468                    | 28,400    | 68      |
| Total Noninterest Expense                     | \$81,181                    | \$80,747 | \$434   | \$165,568                 | \$165,954 | \$(386) |

Salaries and benefits expense increased by \$1.3 million or 3% in the second quarter of 2013 compared to the same period in 2012. Salaries expense increased by \$0.9 million primarily due to merit increases and higher executive

deferred compensation expense. In addition, separation expense increased by \$0.5 million, while medical, dental, and life insurance expense increased by \$0.2 million primarily due to higher medical insurance costs. Partially offsetting these increases was a \$0.5 million decrease in share-based compensation primarily due to amortization expense recorded in the second quarter of 2012 related to stock options granted during that period. These stock options were fully amortized in 2012. In contrast, stock options were not granted during the current period. Salaries and benefits expense increased by \$3.0 million or 3% for the first six months of 2013 compared to the same period in 2012 primarily due to a \$1.5 million increase in separation expense. Salaries expense increased by \$1.3 million primarily due to a lower amount of salaries deferred in the current year, the result of lower portfolio loan production compared to the prior year. Medical, dental, and life insurance increased by \$0.6 million primarily due to higher medical insurance costs and a reserve credit adjustment made in 2012. Payroll taxes increased by \$0.6 million primarily due to an increase in state unemployment taxes. Partially offsetting these increases was a \$1.0 million decrease in share-based compensation as noted above.

Net occupancy expense decreased by \$0.4 million or 4% in the second quarter of 2013 compared to the same period in 2012. This decrease was primarily due to a \$0.9 million decline in net rental expense as a result of branch closures during 2012, combined with higher sublease revenue in the current quarter. This decrease was partially offset by a \$0.5 million gain recognized in the second quarter of 2012 upon adjusting the book value of two bank-owned properties to fair value prior to being donated. Net occupancy expense decreased by \$1.3 million or 6% for the first six months of 2013 compared to the same period in 2012. This decrease was primarily due to a \$1.3 million decline in net rental expense as a result of the aforementioned 2012 branch closures and higher 2013 sublease revenue.

Net equipment expense decreased by \$0.3 million or 6% in the second quarter of 2013 compared to the same period in 2012. This decrease was primarily due to a \$0.2 million decrease in depreciation expense. Net equipment expense decreased by \$1.5 million or 15% for the first six months of 2013 compared to the same period in 2012. This decrease was primarily due to the \$1.2 million purchase of technology equipment in the first quarter of 2012, combined with a \$0.4 million decrease in depreciation expense in the first six months of 2013.

Other noninterest expense remained relatively unchanged during the second quarter of 2013 compared to the same period in 2012. Increases were primarily due to a \$0.5 million increase in our reserve for unfunded commitments, a \$0.3 million increase in operational losses, and \$0.3 million in legal settlement reserve credit adjustments recorded in the second quarter of 2012. These increases were largely offset by the donation in the second quarter of 2012 of two bank-owned properties appraised at \$1.0 million. Other noninterest expense remained relatively unchanged during the first six months of 2013 compared to the same period in 2012. Increases were primarily due to the aforementioned \$0.5 million increase in our reserve for unfunded commitments, \$0.5 million in expenses related to the recent launch of our new consumer credit cards, a \$0.5 million increase in operational losses, and the aforementioned \$0.3 million in legal settlement reserve credit adjustments recorded in the second quarter of 2012. These increases were largely offset by the aforementioned donation in the second quarter of 2012 of two bank-owned properties appraised at \$1.0 million combined with a \$0.7 million decrease in foreclosed real estate expense resulting mainly from gains on disposals during the current year combined with a write-down taken during the first quarter of 2012.

## Provision for Income Taxes

Table 7 presents our provision for income taxes and effective tax rates.

| Provision for Income Taxes and Effective Tax Rates |                    |          |   | Table 7          |          |   |   |
|----------------------------------------------------|--------------------|----------|---|------------------|----------|---|---|
| (dollars in thousands)                             | Three Months Ended |          |   | Six Months Ended |          |   |   |
|                                                    | June 30,           | 2012     |   | June 30,         | 2012     |   |   |
| Provision for Income Taxes                         | \$16,437           | \$20,107 |   | \$32,408         | \$36,769 |   |   |
| Effective Tax Rates                                | 30.33              | % 33.04  | % | 30.53            | % 30.31  | % | % |

The provision for income taxes in the second quarter of 2013 was \$3.7 million or 18% lower compared to the same period in 2012 primarily due to lower pretax income. The lower provision for income taxes was also favorably impacted by a \$1.1 million benefit recorded in the second quarter of 2013 for the release of reserves due to the closing of a state audit for a prior year.

The provision for income taxes for the first six months of 2013 was \$4.4 million or 12% lower compared to the same period in 2012 primarily due to lower pretax income. The provision for income taxes for the first six months of 2013 was favorably impacted by the release of reserves noted above, while the provision for income taxes for the first six months of 2012 was favorably impacted by the sale of our equity interest in two cargo ship leveraged leases, which

resulted in a \$2.7 million credit to the provision for income taxes in the first quarter of 2012.

## Analysis of Statements of Condition

### Investment Securities

The carrying value of our investment securities portfolio was \$6.8 billion as of June 30, 2013, a decrease of \$119.4 million or 2% compared to December 31, 2012.

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, change the composition of our investment securities portfolio, and change the proportion of investments made into the available-for-sale and held-to-maturity investment categories.

During the first six months of 2013, we continued to reduce our positions in mortgage-backed securities issued by the Government National Mortgage Corporation ("Ginnie Mae") in an effort to manage extension risk related to our mortgage-backed securities. We re-invested these proceeds, in part, into corporate bonds and state and municipal bond holdings. As of June 30, 2013, our portfolio of Ginnie Mae mortgage-backed securities were primarily comprised of securities issued between 2008 and 2011. As of June 30, 2013, the credit ratings of these mortgage-backed securities were all AAA-rated, with a low probability of a change in ratings in the near future. As of June 30, 2013, our available-for-sale investment securities portfolio was comprised of securities with an average base duration of approximately three years.

Gross unrealized gains in our investment securities portfolio were \$89.9 million as of June 30, 2013 and \$172.3 million as of December 31, 2012. Gross unrealized losses on our temporarily impaired investment securities were \$83.7 million as of June 30, 2013 and \$3.8 million as of December 31, 2012. This increase in our gross unrealized loss positions on our temporarily impaired investment securities was primarily due to an increase in interest rates in the second quarter of 2013, relative to the interest rate environment when the investment securities were purchased. The gross unrealized loss positions were primarily related to mortgage-backed securities issued by government agencies, state and municipal bond holdings, and corporate bonds.

As of June 30, 2013, included in our investment securities at fair value were securities issued by political subdivisions within the State of Hawaii of \$569.9 million, representing 70% of the total fair value of the Company's municipal debt securities. Of the entire Hawaii municipal bond portfolio, 94% were credit-rated Aa2 or better by Moody's while the remaining Hawaii municipal bonds were credit-rated A2 or better by at least one nationally recognized statistical rating organization. Also, approximately 76% of our Hawaii municipal bond holdings were general obligation issuances. As of June 30, 2013, there were no other holdings of municipal debt securities that were issued by a single state or political subdivision which comprised more than 5% of the total fair value of our municipal debt securities. As of June 30, 2013, we did not own any subordinated debt, or preferred or common stock of the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation. See Note 2 to the Consolidated Financial Statements for more information.

## Loans and Leases

Table 8 presents the composition of our loan and lease portfolio by major categories.

| Loan and Lease Portfolio Balances<br>(dollars in thousands) | June 30,<br>2013 | Table 8<br>December 31,<br>2012 |
|-------------------------------------------------------------|------------------|---------------------------------|
| Commercial                                                  |                  |                                 |
| Commercial and Industrial                                   | \$875,702        | \$829,512                       |
| Commercial Mortgage                                         | 1,160,977        | 1,097,425                       |
| Construction                                                | 107,016          | 113,987                         |
| Lease Financing                                             | 257,067          | 274,969                         |
| Total Commercial                                            | 2,400,762        | 2,315,893                       |
| Consumer                                                    |                  |                                 |
| Residential Mortgage                                        | 2,252,117        | 2,349,916                       |
| Home Equity                                                 | 751,790          | 770,376                         |
| Automobile                                                  | 233,475          | 209,832                         |
| Other <sup>1</sup>                                          | 221,008          | 208,504                         |
| Total Consumer                                              | 3,458,390        | 3,538,628                       |
| Total Loans and Leases                                      | \$5,859,152      | \$5,854,521                     |

<sup>1</sup> Comprised of other revolving credit, installment, and lease financing.

Total loans and leases as of June 30, 2013 remained relatively unchanged from December 31, 2012.

Commercial loans and leases as of June 30, 2013 increased by \$84.9 million or 4% from December 31, 2012. Commercial and industrial loans increased by \$46.2 million or 6% from December 31, 2012 due to an increase in corporate demand for funding, reflective of an improving Hawaii economy. Commercial mortgage loans increased by \$63.6 million or 6% from December 31, 2012 primarily due to increased demand from new and existing customers. Construction loans decreased by \$7.0 million or 6% from December 31, 2012. Upon the completion of the construction phase of one borrower's development project, the balance of the loan was transferred to the commercial mortgage category in the second quarter of 2013. Lease financing decreased by \$17.9 million or 7% from December 31, 2012 primarily due to continued paydowns in this portfolio.

Consumer loans and leases as of June 30, 2013 decreased by \$80.2 million or 2% from December 31, 2012. Residential mortgage loans decreased by \$97.8 million or 4% from December 31, 2012 primarily due to lower loan originations, the result of higher interest rates and continued paydowns in this portfolio during the first six months of 2013. Home equity loans decreased by \$18.6 million or 2% from December 31, 2012 primarily due to continued paydowns and reduced line utilization. Automobile loans increased by \$23.6 million or 11% from December 31, 2012 primarily due to increased customer demand. Other consumer loans increased by \$12.5 million or 6% from December 31, 2012 primarily due to a successful installment loan campaign in the second quarter of 2013.

Table 9 presents the composition of our loan and lease portfolio by geographic area and by major categories.

Geographic Distribution of Loan and Lease Portfolio

Table 9

| (dollars in thousands)    | Hawaii      | U.S.<br>Mainland <sup>1</sup> | Guam      | Other<br>Pacific Islands | Foreign <sup>2</sup> | Total       |
|---------------------------|-------------|-------------------------------|-----------|--------------------------|----------------------|-------------|
| June 30, 2013             |             |                               |           |                          |                      |             |
| Commercial                |             |                               |           |                          |                      |             |
| Commercial and Industrial | \$783,095   | \$35,518                      | \$55,156  | \$1,693                  | \$240                | \$875,702   |
| Commercial Mortgage       | 1,049,985   | 32,832                        | 78,160    | —                        | —                    | 1,160,977   |
| Construction              | 99,182      | —                             | 7,834     | —                        | —                    | 107,016     |
| Lease Financing           | 32,278      | 193,362                       | 8,654     | —                        | 22,773               | 257,067     |
| Total Commercial          | 1,964,540   | 261,712                       | 149,804   | 1,693                    | 23,013               | 2,400,762   |
| Consumer                  |             |                               |           |                          |                      |             |
| Residential Mortgage      | 2,122,913   | —                             | 125,153   | 4,051                    | —                    | 2,252,117   |
| Home Equity               | 723,425     | 6,273                         | 20,197    | 1,895                    | —                    | 751,790     |
| Automobile                | 173,807     | 2,583                         | 53,471    | 3,614                    | —                    | 233,475     |
| Other <sup>3</sup>        | 155,684     | —                             | 26,262    | 39,056                   | 6                    | 221,008     |
| Total Consumer            | 3,175,829   | 8,856                         | 225,083   | 48,616                   | 6                    | 3,458,390   |
| Total Loans and Leases    | \$5,140,369 | \$270,568                     | \$374,887 | \$50,309                 | \$23,019             | \$5,859,152 |
| December 31, 2012         |             |                               |           |                          |                      |             |
| Commercial                |             |                               |           |                          |                      |             |
| Commercial and Industrial | \$726,401   | \$29,571                      | \$70,622  | \$2,213                  | \$705                | \$829,512   |
| Commercial Mortgage       | 988,165     | 33,240                        | 76,020    | —                        | —                    | 1,097,425   |
| Construction              | 109,956     | —                             | 4,031     | —                        | —                    | 113,987     |
| Lease Financing           | 31,871      | 207,236                       | 13,070    | —                        | 22,792               | 274,969     |
| Total Commercial          | 1,856,393   | 270,047                       | 163,743   | 2,213                    | 23,497               | 2,315,893   |
| Consumer                  |             |                               |           |                          |                      |             |
| Residential Mortgage      | 2,209,882   | —                             | 135,491   | 4,543                    | —                    | 2,349,916   |
| Home Equity               | 740,939     | 7,784                         | 19,682    | 1,971                    | —                    | 770,376     |
| Automobile                | 152,031     | 4,068                         | 50,716    | 3,017                    | —                    | 209,832     |
| Other <sup>3</sup>        | 148,724     | —                             | 23,867    | 35,904                   | 9                    | 208,504     |
| Total Consumer            | 3,251,576   | 11,852                        | 229,756   | 45,435                   | 9                    | 3,538,628   |
| Total Loans and Leases    | \$5,107,969 | \$281,899                     | \$393,499 | \$47,648                 | \$23,506             | \$5,854,521 |

For secured loans and leases, classification as U.S. Mainland is made based on where the collateral is located. For <sup>1</sup> 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.

<sup>2</sup> Loans classified as Foreign represent those which are recorded in the Company's international business units. Lease financing classified as Foreign represent those with air transportation carriers based outside the United States.

<sup>3</sup> Comprised of other revolving credit, installment, and lease financing.

Our commercial and consumer lending activities are concentrated primarily in Hawaii and the Pacific Islands. Our commercial loan and lease portfolio to borrowers based on the U.S. Mainland includes leveraged lease financing and participation in Shared National Credits. Our consumer loan and lease portfolio includes limited lending activities on the U.S. Mainland.

## Other Assets

Table 10 presents the major components of other assets.

| Other Assets                                          | June 30,  | Table 10<br>December 31, |
|-------------------------------------------------------|-----------|--------------------------|
| (dollars in thousands)                                | 2013      | 2012                     |
| Bank-Owned Life Insurance                             | \$221,061 | \$218,429                |
| Federal Home Loan Bank and Federal Reserve Bank Stock | 78,164    | 79,152                   |
| Derivative Financial Instruments                      | 30,319    | 42,610                   |
| Low-Income Housing and Other Equity Investments       | 45,793    | 48,373                   |
| Prepaid Expenses                                      | 7,565     | 21,820                   |
| Accounts Receivable                                   | 17,766    | 13,854                   |
| State Tax Deposits                                    | 6,069     | 6,069                    |
| Other                                                 | 40,399    | 26,645                   |
| Total Other Assets                                    | \$447,136 | \$456,952                |

Other assets decreased by \$9.8 million or 2% from December 31, 2012. This decrease was primarily due to a \$16.0 million decrease in prepaid expenses as a result of the FDIC returning remaining assessments that were prepaid by us to the FDIC in 2009. Also contributing to the decrease in other assets was an \$8.1 million decrease in the fair value of our interest rate swap agreements and a \$7.3 million decrease in the fair value of our interest rate lock commitments. The fair value of these derivative financial instruments are impacted by interest rate movements and the volume of saleable residential mortgage loans that were in a locked position as of period end. This was partially offset by a \$12.9 million increase in receivables related to the settlement of investment securities that matured, a \$5.4 million increase in receivable related to the settlement of a loan that was fully paid off, and a \$4.1 million increase in the fair value of our forward commitments.

## Deposits

Table 11 presents the composition of our deposits by major customer categories.

| Deposits               | June 30,     | Table 11<br>December 31, |
|------------------------|--------------|--------------------------|
| (dollars in thousands) | 2013         | 2012                     |
| Consumer               | \$5,626,515  | \$5,537,624              |
| Commercial             | 4,537,120    | 4,576,410                |
| Public and Other       | 1,285,563    | 1,415,448                |
| Total Deposits         | \$11,449,198 | \$11,529,482             |

Total deposits were \$11.4 billion as of June 30, 2013, a decrease of \$80.3 million or less than 1% from December 31, 2012. This decrease was primarily due to local government entities transferring funds from deposits to repurchase agreements.

Table 12 presents the composition of our savings deposits.

| Savings Deposits       | June 30,    | Table 12<br>December 31, |
|------------------------|-------------|--------------------------|
| (dollars in thousands) | 2013        | 2012                     |
| Money Market           | \$1,615,329 | \$1,607,738              |
| Regular Savings        | 2,817,713   | 2,791,578                |
| Total Savings Deposits | \$4,433,042 | \$4,399,316              |



Table 13 presents our quarterly average balance of time deposits of \$100,000 or more.

| Average Time Deposits of \$100,000 or More | Table 13           |                      |
|--------------------------------------------|--------------------|----------------------|
|                                            | Three Months Ended |                      |
| (dollars in thousands)                     | June 30,<br>2013   | December 31,<br>2012 |
| Average Time Deposits                      | \$1,063,173        | \$1,423,228          |

#### Borrowings

As of June 30, 2013, borrowings were \$10.0 million, a decrease of \$1.3 million or 12% from December 31, 2012. These borrowings primarily consisted of overnight funds purchased and the amounts borrowed fluctuate depending on our daily funding requirements.

#### Securities Sold Under Agreements to Repurchase

Table 14 presents the composition of our securities sold under agreements to repurchase.

| Securities Sold Under Agreements to Repurchase       | Table 14         |                      |
|------------------------------------------------------|------------------|----------------------|
|                                                      | June 30, 2013    |                      |
| (dollars in thousands)                               | June 30,<br>2013 | December 31,<br>2012 |
| Government Entities                                  | \$266,237        | \$158,947            |
| Private Institutions                                 | 600,000          | 600,000              |
| Total Securities Sold Under Agreements to Repurchase | \$866,237        | \$758,947            |

Securities sold under agreements to repurchase as of June 30, 2013 increased by \$107.3 million or 14% from December 31, 2012. This increase was primarily due to local government entities transferring funds from deposits to repurchase agreements. As of June 30, 2013, the weighted average maturity was 250 days for our repurchase agreements with government entities and 5.5 years for our repurchase agreements with private institutions. Some of our repurchase agreements with private institutions may be terminated at earlier specified dates by the private institution or in some cases by either the private institution or the Company. If all such agreements were to terminate at the earliest possible date, the weighted average maturity for our repurchase agreements with private institutions would decrease to 3.1 years. As of June 30, 2013, the weighted average interest rate for outstanding agreements with government entities and private institutions was 0.10% and 4.31%, respectively, with all rates being fixed. All of our repurchase agreements are accounted for as collateralized financing arrangements (i.e., secured borrowings) and not as a sale and subsequent repurchase of securities.

During the second quarter of 2013, we modified the terms on eight of our repurchase agreements with private institutions totaling \$200.0 million. The modifications involved extending the maturity date and lowering the interest rate. The original maturity dates, ranging from 2015 to 2016, were extended to 2018 to 2020, while the weighted average interest rate was lowered from 4.73% to 3.75%. In addition, these repurchase agreements originally allowed highly rated investments such as U.S. agency mortgage-backed securities to be posted as collateral. As a condition of the modified terms, we are now required to post U.S Treasury securities as collateral.

#### Long-Term Debt

Long-term debt was \$174.7 million as of June 30, 2013, a \$46.7 million or 36% increase from December 31, 2012. This increase was due to a \$50.0 million advance that we received from the FHLB in the first quarter of 2013. The stated interest rate on the advance is 0.60% with maturity in February 2016. The advance from the FHLB was primarily for asset/liability management purposes. As of June 30, 2013, our remaining line of credit with the FHLB was \$1.0 billion.



## Analysis of Business Segments

Our business segments are defined as Retail Banking, Commercial Banking, Investment Services, and Treasury and Other.

Table 15 summarizes net income from our business segments. Additional information about segment performance is presented in Note 8 to the Consolidated Financial Statements.

| Business Segment Net Income | Table 15           |          |                  |          |
|-----------------------------|--------------------|----------|------------------|----------|
|                             | Three Months Ended |          | Six Months Ended |          |
|                             | June 30,           |          | June 30,         |          |
| (dollars in thousands)      | 2013               | 2012     | 2013             | 2012     |
| Retail Banking              | \$7,055            | \$8,818  | \$13,205         | \$15,800 |
| Commercial Banking          | 10,011             | 11,593   | 20,898           | 28,737   |
| Investment Services         | 2,998              | 2,208    | 5,182            | 3,628    |
| Total                       | 20,064             | 22,619   | 39,285           | 48,165   |
| Treasury and Other          | 17,699             | 18,128   | 34,458           | 36,392   |
| Consolidated Total          | \$37,763           | \$40,747 | \$73,743         | \$84,557 |

## Retail Banking

Net income decreased by \$1.8 million or 20% in the second quarter of 2013 compared to the same period in 2012 primarily due to decreases in net interest income and noninterest income, partially offset by decreases in the Provision and noninterest expense. The decrease in net interest income was primarily due to lower earnings credits on the segment's deposit portfolio, partially offset by higher average deposit balances and higher margins on the segment's loan portfolio. The decrease in noninterest income was primarily due to lower mortgage banking income. The decrease in the Provision was primarily due to lower net charge-offs of loans and leases in the segment combined with improving credit trends and the underlying risk profile of the loan portfolio. The decrease in noninterest expense was primarily due to lower occupancy expense related to the closure of several branches in 2012.

Net income decreased by \$2.6 million or 16% for the first six months of 2013 compared to the same period in 2012 primarily due to a decrease in net interest income, partially offset by decreases in the Provision and noninterest expense. The decrease in net interest income was primarily due to lower earnings credits on the segment's deposit portfolio, partially offset by higher average deposit balances, higher loan balances, and higher margins on the segment's loan portfolio. The decrease in the Provision was primarily due to lower net charge-offs of loans and leases in the segment combined with improving credit trends and the underlying risk profile of the loan portfolio. The decrease in noninterest expense was primarily due to lower occupancy expense related to the closure of several branches in 2012.

## Commercial Banking

Net income decreased by \$1.6 million or 14% in the second quarter of 2013 compared to the same period in 2012 primarily due to a decrease in net interest income and an increase in noninterest expense, partially offset by an increase in noninterest income. The decrease in net interest income was due to lower earnings credits on the segment's deposit portfolio, partially offset by an increase in loan margins attributed to strong loan growth. The increase in noninterest expense was primarily due to higher allocated expenses. Noninterest income increased due to higher loan fees and net gains on the sale of leased assets.

Net income decreased by \$7.8 million or 27% for the first six months of 2013 compared to the same period in 2012 primarily due to an increase in the provision for income taxes and decreases in noninterest income and net interest

income. Both the increase in the provision for income taxes and the decrease in noninterest income were attributable to a gain recognized upon a lessee exercising its early buy-out option on two cargo ship leveraged leases in the first quarter of 2012. The decrease in net interest income was due to lower earnings credits on the segment's deposit portfolio, partially offset by an increase in loan margins attributed to strong loan growth.

#### Investment Services

Net income increased by \$0.8 million or 36% in the second quarter of 2013 compared to the same period in 2012 primarily due to an increase in noninterest income and a decrease in noninterest expense, partially offset by a decrease in net interest income. The increase in noninterest income was primarily due to higher trust and asset management income attributed to an increase in average market value of assets under administration and an increase in investment advisory fees. The decrease in noninterest

expense was primarily due to lower salaries expense. The decrease in net interest income was primarily due to lower earnings credits on the segment's deposit portfolio.

Net income increased by \$1.6 million or 43% for the first six months of 2013 compared to the same period in 2012 primarily due to an increase in noninterest income and a decrease in noninterest expense, partially offset by a decrease in net interest income. The increase in noninterest income was primarily due to higher trust and asset management income attributed to an increase in average market value of assets under administration and an increase in investment advisory fees. The decrease in noninterest expense was primarily due to lower salaries, and occupancy and equipment expenses. The decrease in net interest income was primarily due to lower earnings credits on the segment's deposit portfolio.

#### Treasury and Other

Net income decreased by \$0.4 million or 2% in the second quarter of 2013 and by \$1.9 million or 5% for the first six months of 2013 compared to the same periods in 2012 primarily due to a decrease in net interest income combined with increases in noninterest expense and the Provision. The decrease in net interest income was primarily due to lower interest income from the investment securities portfolio resulting from lower volume and associated yields. Additionally, funding income related to lending activities decreased. This was partially offset by lower deposit funding costs. The increase in noninterest expense was primarily due to an increase in separation expense. The Provision in this business segment represents the residual provision for credit losses to arrive at the total Provision for the Company.

Other organizational units (Technology, Operations, Marketing, Human Resources, Finance, Credit and Risk Management, and Corporate and Regulatory Administration) included in Treasury and Other 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.

#### Corporate Risk Profile

##### Credit Risk

As of June 30, 2013, our overall credit risk position reflects an improving Hawaii economy, with decreasing levels of higher risk loans and leases, levels of non-performing assets which appear to have stabilized, and lower credit losses. The tourism industry is leading the economic recovery in Hawaii with increases in visitor arrivals and spending. The statewide seasonally-adjusted unemployment rate continues to show signs of stabilization. The underlying risk profile of our lending portfolio continued to improve in the second quarter of 2013 as a result of these improvements in economic and credit quality trends in our portfolio.

Although asset quality has improved over the past several years, we remain vigilant in light of uncertainties in the U.S. economy as well as concerns related to specific segments of our lending portfolio that present a higher risk profile. As of June 30, 2013, the higher risk segments within our loan and lease portfolio were concentrated in residential land loans, home equity loans, and air transportation leases. In addition, loans and leases based on Hawaiian Islands other than Oahu (the "neighbor islands") may present a higher risk profile as the neighbor islands have continued to experience higher levels of unemployment and have shown signs of slower economic recovery when compared to Oahu.

We continue to monitor our loan and lease portfolio to identify higher risk segments. We also actively manage exposures with deteriorating asset quality to reduce levels of potential loss exposure and have systematically built our reserves and capital base to address both anticipated and unforeseen issues. Risk management activities have included

curtailing activities in some higher risk segments. We have also conducted detailed analysis of portfolio segments and stress tested those segments to ensure that reserve and capital levels are appropriate. We are also performing frequent loan and lease-level risk monitoring and risk rating review which provides opportunities for early interventions to allow for credit exits or restructuring, loan and lease sales, and voluntary workouts and liquidations.

Table 16 presents balances in our loan and lease portfolio which demonstrate a higher risk profile.

60

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| Higher Risk Loans and Leases Outstanding<br>(dollars in thousands) | Table 16         |                      |
|--------------------------------------------------------------------|------------------|----------------------|
|                                                                    | June 30,<br>2013 | December 31,<br>2012 |
| Residential Land Loans                                             | \$13,708         | \$14,984             |
| Home Equity Loans                                                  | 13,578           | 19,914               |
| Air Transportation Leases                                          | 26,436           | 27,782               |
| Total                                                              | \$53,722         | \$62,680             |

As of June 30, 2013, our higher risk loans and leases outstanding decreased by \$9.0 million or 14% from December 31, 2012.

Residential land loans in our residential mortgage portfolio consist of consumer loans secured by unimproved lots. These loans often represent higher risk due to the volatility in the value of the underlying collateral. Our residential land loan portfolio was \$13.7 million as of June 30, 2013, of which \$11.8 million was related to properties on the neighbor islands. Residential land loans that have not been modified in a troubled debt restructuring ("TDR") are collectively evaluated for impairment in connection with the evaluation of our residential mortgage portfolio. As of June 30, 2013, there was a nominal specific Allowance associated with the remaining balance of our residential land loans. As of June 30, 2013, \$1.6 million of our residential land loans were on non-accrual status and we have previously recorded partial charge-offs of \$1.3 million on these loans.

The higher risk segment within our Hawaii home equity lending portfolio was \$13.6 million or 2% of our total home equity loans outstanding as of June 30, 2013, a decrease of \$6.3 million or 32% from December 31, 2012. This decrease was primarily due to an improvement in credit scores. The higher risk segment within our Hawaii home equity portfolio includes those loans originated in 2005 or later, with current monitoring credit scores below 600, and with original loan-to-value ("LTV") ratios greater than 70%. Higher risk loans in our Hawaii home equity portfolio are collectively evaluated for impairment in connection with the evaluation of our entire home equity portfolio. As of June 30, 2013, there was no specific Allowance associated with the balance of our higher risk home equity loans. These loans had a 90 day past due delinquency ratio of 5.8% and \$1.9 million in gross charge-offs were recorded during the first six months of 2013.

We consider all of our air transportation leases to be of higher risk due to the volatile financial profile of the industry. Domestic air transportation carriers continue to demonstrate a higher risk profile due to fuel costs, pension plan obligations, consumer demand, and marginal pricing power. Carriers are migrating to newer generations of more fuel efficient fleets which are negatively impacting older generation aircraft valuations. We believe that volatile fuel costs, coupled with a slowly recovering economy, could place additional pressure on the financial health of air transportation carriers for the foreseeable future. As of June 30, 2013, our air transportation leasing portfolio was comprised of four leveraged leases on aircraft that were originated in the 1990's and prior. As of June 30, 2013, the Allowance associated with our air transportation leases was \$9.9 million. For the first six months of 2013, there were no delinquencies in our air transportation lease portfolio and no charge-offs were recorded.

All of these higher risk loans and leases have been considered in our quarterly evaluation of the adequacy of the Allowance.

## Non-Performing Assets

Table 17 presents information on non-performing assets (“NPAs”) and accruing loans and leases past due 90 days or more.

| Non-Performing Assets and Accruing Loans and Leases Past Due 90 Days or More<br>(dollars in thousands)                   | June 30,<br>2013 | Table 17<br>December 31,<br>2012 |  |   |
|--------------------------------------------------------------------------------------------------------------------------|------------------|----------------------------------|--|---|
| Non-Performing Assets                                                                                                    |                  |                                  |  |   |
| Non-Accrual Loans and Leases                                                                                             |                  |                                  |  |   |
| Commercial                                                                                                               |                  |                                  |  |   |
| Commercial and Industrial                                                                                                | \$4,909          | \$5,534                          |  |   |
| Commercial Mortgage                                                                                                      | 2,772            | 3,030                            |  |   |
| Construction                                                                                                             | —                | 833                              |  |   |
| Lease Financing                                                                                                          | 16               | —                                |  |   |
| Total Commercial                                                                                                         | 7,697            | 9,397                            |  |   |
| Consumer                                                                                                                 |                  |                                  |  |   |
| Residential Mortgage                                                                                                     | 22,876           | 21,725                           |  |   |
| Home Equity                                                                                                              | 2,602            | 2,074                            |  |   |
| Total Consumer                                                                                                           | 25,478           | 23,799                           |  |   |
| Total Non-Accrual Loans and Leases                                                                                       | 33,175           | 33,196                           |  |   |
| Foreclosed Real Estate                                                                                                   | 3,256            | 3,887                            |  |   |
| Total Non-Performing Assets                                                                                              | \$36,431         | \$37,083                         |  |   |
| Accruing Loans and Leases Past Due 90 Days or More                                                                       |                  |                                  |  |   |
| Commercial                                                                                                               |                  |                                  |  |   |
| Commercial and Industrial                                                                                                | \$—              | \$27                             |  |   |
| Total Commercial                                                                                                         | —                | 27                               |  |   |
| Consumer                                                                                                                 |                  |                                  |  |   |
| Residential Mortgage                                                                                                     | 6,876            | 6,908                            |  |   |
| Home Equity                                                                                                              | 2,768            | 2,701                            |  |   |
| Automobile                                                                                                               | 95               | 186                              |  |   |
| Other <sup>1</sup>                                                                                                       | 855              | 587                              |  |   |
| Total Consumer                                                                                                           | 10,594           | 10,382                           |  |   |
| Total Accruing Loans and Leases Past Due 90 Days or More                                                                 | \$10,594         | \$10,409                         |  |   |
| Restructured Loans on Accrual Status and Not Past Due 90 Days or More                                                    | \$39,154         | \$31,844                         |  |   |
| Total Loans and Leases                                                                                                   | \$5,859,152      | \$5,854,521                      |  |   |
| Ratio of Non-Accrual Loans and Leases to Total Loans and Leases                                                          | 0.57             | % 0.57                           |  | % |
| Ratio of Non-Performing Assets to Total Loans and Leases, and Foreclosed Real Estate                                     | 0.62             | % 0.63                           |  | % |
| Ratio of Commercial Non-Performing Assets to Total Commercial Loans and Leases,<br>and Commercial Foreclosed Real Estate | 0.37             | % 0.45                           |  | % |
| Ratio of Consumer Non-Performing Assets to Total Consumer Loans and Leases<br>and Consumer Foreclosed Real Estate        | 0.80             | % 0.75                           |  | % |

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|                                                                                                                                             |      |   |      |   |
|---------------------------------------------------------------------------------------------------------------------------------------------|------|---|------|---|
| Ratio of Non-Performing Assets and Accruing Loans and Leases Past Due 90 Days or More to Total Loans and Leases, and Foreclosed Real Estate | 0.80 | % | 0.81 | % |
|---------------------------------------------------------------------------------------------------------------------------------------------|------|---|------|---|

Changes in Non-Performing Assets

|                                 |          |   |
|---------------------------------|----------|---|
| Balance as of December 31, 2012 | \$37,083 |   |
| Additions                       | 9,951    |   |
| Reductions                      |          |   |
| Payments                        | (3,936   | ) |
| Return to Accrual Status        | (3,110   | ) |
| Sales of Foreclosed Real Estate | (3,167   | ) |
| Charge-offs/Write-downs         | (390     | ) |
| Total Reductions                | (10,603  | ) |
| Balance as of June 30, 2013     | \$36,431 |   |

<sup>1</sup> Comprised of other revolving credit, installment, and lease financing.

NPAs consist of non-accrual loans and leases, and foreclosed real estate. 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 foreclosed real estate, or are no longer classified as non-accrual because they have returned to accrual status.

Total NPAs were \$36.4 million as of June 30, 2013, a decrease of \$0.7 million or 2% from December 31, 2012. The ratio of our NPAs to total loans and leases, and foreclosed real estate was 0.62% as of June 30, 2013 and 0.63% as of December 31, 2012.

Commercial and industrial non-accrual loans decreased by \$0.6 million or 11% from December 31, 2012 due to paydowns. As of June 30, 2013, three commercial borrowers comprised over 99% of the non-accrual balance in this category. We individually evaluated each of these loans for impairment and have previously recorded partial charge-offs of \$5.3 million on two of these loans.

Commercial mortgage non-accrual loans decreased by \$0.3 million or 9% from December 31, 2012 due to paydowns. We have individually evaluated all five of these loans for impairment and have previously recorded a partial charge-off of \$0.5 million on one of these loans.

There was one construction non-accrual loan as of December 31, 2012. This loan was sold in the first three months of 2013 and a prior partial charge-off of \$0.3 million was fully recovered.

Residential mortgage non-accrual loans increased by \$1.2 million or 5% from December 31, 2012 primarily due to \$6.5 million in additions of which 31% were Oahu owner-occupant properties. This increase was partially offset by \$3.9 million in paydowns. Residential mortgage non-accrual loans remain at elevated levels due mainly to the lengthy judiciary foreclosure process. As of June 30, 2013, our residential mortgage non-accrual loans were comprised of 59 loans with a weighted average current LTV ratio of 74%.

Foreclosed real estate represents property acquired as the result of borrower defaults on loans. Foreclosed real estate 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. Foreclosed real estate decreased by \$0.6 million or 16% from December 31, 2012. During the first six months of 2013, 11 residential properties were sold and eight residential properties were transferred to foreclosed real estate. As of June 30, 2013, foreclosed real estate is comprised of one commercial property and five residential properties, four in Hawaii and one in Guam.

Included in NPAs are loans that we consider impaired. Impaired loans are defined as loans for which we believe it is probable we will not collect all amounts due according to the contractual terms of the loan agreement. Included in impaired loans are all classes of commercial non-accruing loans (except lease financing and small business loans), and all loans modified in a TDR. Impaired loans exclude lease financing and smaller balance homogeneous loans (consumer and small business non-accruing loans) that are collectively evaluated for impairment. Impaired loans were \$56.8 million as of June 30, 2013 and \$50.6 million as of December 31, 2012, and had a related Allowance of \$4.1 million as of June 30, 2013 and \$3.7 million as of December 31, 2012. As of June 30, 2013, we have recorded charge-offs of \$12.0 million related to our impaired loans. Our impaired loans are considered in management's assessment of the overall adequacy of the Allowance.

#### 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 \$10.6 million as of June 30, 2013, a \$0.2 million or 2% increase from December 31, 2012. The

increase was primarily in our other consumer portfolio.

Table 18 presents information on loans with terms that have been modified in a TDR.

Loans Modified in a Troubled Debt Restructuring

| (dollars in thousands)    | June 30,<br>2013 | Table 18<br>December 31,<br>2012 |
|---------------------------|------------------|----------------------------------|
| Commercial                |                  |                                  |
| Commercial and Industrial | \$7,305          | \$4,319                          |
| Commercial Mortgage       | 6,642            | 1,032                            |
| Construction              | —                | 833                              |
| Total Commercial          | 13,947           | 6,184                            |
| Consumer                  |                  |                                  |
| Residential Mortgage      | 31,327           | 29,036                           |
| Automobile                | 5,151            | 5,641                            |
| Other <sup>1</sup>        | 278              | 282                              |
| Total Consumer            | 36,756           | 34,959                           |
| Total                     | \$50,703         | \$41,143                         |

<sup>1</sup> Comprised of other revolving credit, installment, and lease financing.

Loans modified in a TDR increased by \$9.6 million or 23% from December 31, 2012. Commercial TDRs increased primarily due to modifications of performing Classified loans that were completed in conjunction with the renewals of these facilities. These additional Commercial TDRs all remain on accrual status as scheduled payments continue to be received. The majority of our TDRs are residential mortgage loans in which we lowered monthly payments to accommodate the borrowers' financial needs for a period of time. 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 payments.

## Reserve for Credit Losses

Table 19 presents the activity in our reserve for credit losses.

## Reserve for Credit Losses

Table 19

|                                                                                                | Three Months Ended<br>June 30, |             | Six Months Ended<br>June 30, |             |
|------------------------------------------------------------------------------------------------|--------------------------------|-------------|------------------------------|-------------|
| (dollars in thousands)                                                                         | 2013                           | 2012        | 2013                         | 2012        |
| Balance at Beginning of Period                                                                 | \$132,297                      | \$141,025   | \$134,276                    | \$144,025   |
| Loans and Leases Charged-Off                                                                   |                                |             |                              |             |
| Commercial                                                                                     |                                |             |                              |             |
| Commercial and Industrial                                                                      | (266                           | ) (1,078    | ) (648                       | ) (2,509    |
| Construction                                                                                   | —                              | —           | —                            | (330        |
| Consumer                                                                                       |                                |             |                              |             |
| Residential Mortgage                                                                           | (188                           | ) (1,369    | ) (1,423                     | ) (2,949    |
| Home Equity                                                                                    | (2,016                         | ) (1,657    | ) (3,393                     | ) (4,098    |
| Automobile                                                                                     | (429                           | ) (438      | ) (1,004                     | ) (964      |
| Other <sup>1</sup>                                                                             | (1,805                         | ) (1,394    | ) (3,535                     | ) (2,845    |
| Total Loans and Leases Charged-Off                                                             | (4,704                         | ) (5,936    | ) (10,003                    | ) (13,695   |
| Recoveries on Loans and Leases Previously Charged-Off                                          |                                |             |                              |             |
| Commercial                                                                                     |                                |             |                              |             |
| Commercial and Industrial                                                                      | 437                            | 524         | 875                          | 2,457       |
| Commercial Mortgage                                                                            | 14                             | 10          | 24                           | 34          |
| Construction                                                                                   | 8                              | —           | 346                          | —           |
| Lease Financing                                                                                | 11                             | 11          | 22                           | 83          |
| Consumer                                                                                       |                                |             |                              |             |
| Residential Mortgage                                                                           | 634                            | 376         | 1,422                        | 1,042       |
| Home Equity                                                                                    | 335                            | 165         | 1,083                        | 735         |
| Automobile                                                                                     | 456                            | 482         | 917                          | 1,020       |
| Other <sup>1</sup>                                                                             | 506                            | 577         | 1,032                        | 1,182       |
| Total Recoveries on Loans and Leases Previously Charged-Off                                    | 2,401                          | 2,145       | 5,721                        | 6,553       |
| Net Loans and Leases Charged-Off                                                               | (2,303                         | ) (3,791    | ) (4,282                     | ) (7,142    |
| Provision for Credit Losses                                                                    | —                              | 628         | —                            | 979         |
| Provision for Unfunded Commitments                                                             | 500                            | —           | 500                          | —           |
| Balance at End of Period <sup>2</sup>                                                          | \$130,494                      | \$137,862   | \$130,494                    | \$137,862   |
| Components                                                                                     |                                |             |                              |             |
| Allowance for Loan and Lease Losses                                                            | \$124,575                      | \$132,443   | \$124,575                    | \$132,443   |
| Reserve for Unfunded Commitments                                                               | 5,919                          | 5,419       | 5,919                        | 5,419       |
| Total Reserve for Credit Losses                                                                | \$130,494                      | \$137,862   | \$130,494                    | \$137,862   |
| Average Loans and Leases Outstanding                                                           | \$5,781,898                    | \$5,641,588 | \$5,792,641                  | \$5,602,473 |
| Ratio of Net Loans and Leases Charged-Off to Average Loans and Leases Outstanding (annualized) | 0.16                           | % 0.27      | % 0.15                       | % 0.26      |
| Ratio of Allowance for Loan and Lease Losses to Loans and Leases Outstanding                   | 2.13                           | % 2.34      | % 2.13                       | % 2.34      |

<sup>1</sup> Comprised of other revolving credit, installment, and lease financing.

<sup>2</sup> Included in this analysis is activity related to the Company's reserve for unfunded commitments, which is separately recorded in other liabilities in the consolidated statements of condition.

We maintain a reserve for credit losses that consists of two components, the Allowance and a reserve for unfunded commitments (the "Unfunded Reserve"). The reserve for credit losses provides for the risk of credit losses inherent in the loan and lease portfolio and is based on loss estimates derived from a comprehensive quarterly evaluation. The evaluation reflects analyses of individual borrowers and historical loss experience, supplemented as necessary by credit judgment that considers observable trends, conditions, and other relevant environmental and economic factors. The level of the Allowance is adjusted by recording an expense or recovery through the Provision. The level of the Unfunded Reserve is adjusted by recording an expense or recovery in other noninterest expense.

### Allowance for Loan and Lease Losses

As of June 30, 2013, the Allowance was \$124.6 million or 2.13% of total loans and leases outstanding, compared with an Allowance of \$128.9 million or 2.20% of total loans and leases outstanding as of December 31, 2012. The decrease in the Allowance was commensurate with improvements in credit quality and a generally improving economy in Hawaii. With continued improvement in the Hawaii economy and in our credit quality, including reductions in our higher risk loan segments, we may require a lower level of the Allowance in future periods.

Net charge-offs of loans and leases were \$2.3 million or 0.16% of total average loans and leases, on an annualized basis, in the second quarter of 2013 compared to \$3.8 million or 0.27% of total average loans and leases, on an annualized basis, in the second quarter of 2012. Net charge-offs of loans and leases were \$4.3 million or 0.15% of total average loans and leases, on an annualized basis, in the first six months of 2013 compared to \$7.1 million or 0.26% of total average loans and leases, on an annualized basis, in the first six months of 2012. All of our commercial portfolios were in net recovery positions for the first six months of 2013. Net recoveries in our commercial portfolios were \$0.6 million for the first six months of 2013 compared to net charge-offs of \$0.3 million for the same period in 2012. Net charge-offs in our consumer portfolios were \$4.9 million for the first six months of 2013 compared to \$6.9 million for the same period in 2012. The decrease was primarily reflected in our consumer real estate portfolios. Current year net charge-offs were primarily in our other consumer and home equity portfolios. The risk profile of our consumer loan portfolios continue to be negatively impacted by lower neighbor island residential real estate prices.

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, 2013, based on our ongoing analysis of estimated probable credit losses, credit risk profiles, economic conditions, coverage ratios, and other relevant factors.

### The Reserve for Unfunded Commitments

The Unfunded Reserve was \$5.9 million as of June 30, 2013, an increase of \$0.5 million or 9% from December 31, 2012. The increase in the Unfunded Reserve was primarily due to growth in commercial commitments to lend. The process used to determine the Unfunded Reserve is consistent with the process for determining the Allowance, as adjusted for estimated funding probabilities or loan and lease equivalency factors.

### Market Risk

Market risk is the potential of loss arising from adverse changes in interest rates and prices. We are exposed to market risk as a consequence of the normal course of conducting our business activities. Our market risk management process involves measuring, monitoring, controlling, and mitigating risks that can significantly impact our statements of income and condition. In this management process, market risks are balanced with expected returns in an effort to enhance earnings performance, while limiting volatility.

Our primary market risk exposure is interest rate risk.

### Interest Rate Risk

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. 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. This interest rate risk arises primarily from our core business activities of extending loans and accepting deposits. Our investment securities portfolio is also subject to significant interest rate risk.

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 U.S. and its agencies, particularly the Federal Reserve Bank (the “FRB”). The monetary policies of the FRB can influence the overall growth of loans, investment securities, and deposits and the level of interest rates earned on assets and paid for liabilities. The nature and impact of future changes in monetary policies are generally not predictable.

In managing interest rate risk, we, through the Asset/Liability Management Committee (“ALCO”), measure short and long-term sensitivities to changes in interest rates. The ALCO, which is comprised of members of executive management, utilizes several techniques to manage interest rate risk, which include:

- adjusting the balance sheet mix or altering the interest rate characteristics of assets and liabilities;
- changing product pricing strategies;
- modifying characteristics of the investment securities portfolio; or
- using derivative financial instruments.

Our use of derivative financial instruments, as detailed in Note 10 to the 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.

A key element in our ongoing process to measure and monitor interest rate risk is the utilization of an asset/liability simulation model that attempts to capture the dynamic nature of the balance sheet. The model is used to estimate and measure the balance sheet sensitivity to changes in interest rates. These estimates are based on assumptions on the behavior of loan and deposit pricing, repayment rates on mortgage-based assets, and principal amortization and maturities on other financial instruments. The model’s analytics include the effects of standard prepayment options on mortgages and customer withdrawal options for deposits. While such assumptions are inherently uncertain, we believe that these assumptions are reasonable.

We utilize net interest income simulations to analyze short-term income sensitivities to changes in interest rates. Table 20 presents, for the twelve months subsequent to June 30, 2013 and December 31, 2012, an estimate of the change in net interest income that would result from a gradual and immediate change in interest rates, moving in a parallel fashion over the entire yield curve, relative to the measured base case scenario. The base case scenario assumes the balance sheet and interest rates are generally unchanged. With the recent rise in interest rates and changes to our balance sheet mix, our net interest income simulations indicated that the base case scenario as of June 30, 2013 was approximately 2.7% higher compared to December 31, 2012. As a result, our net interest income sensitivity to changes in interest rates for the twelve months subsequent to June 30, 2013 was slightly less sensitive compared to the sensitivity profile for the twelve months subsequent to December 31, 2012. Also contributing to the slightly reduced sensitivity profile as of June 30, 2013 was the diversification of our investment securities portfolio into securities which were less rate-sensitive, such as municipal bonds and corporate bonds, and the reduction of our positions in mortgage-related assets in order to reduce extension risk in rising interest rate environments. As a result of our strategy to maintain a relatively short investment portfolio duration, net interest income is expected to increase as interest rates rise.

#### Net Interest Income Sensitivity Profile

Table 20

| (dollars in thousands)<br>Gradual Change in Interest Rates (basis points) | Impact on Future Annual Net Interest Income |      |   |                   |      |   |
|---------------------------------------------------------------------------|---------------------------------------------|------|---|-------------------|------|---|
|                                                                           | June 30, 2013                               |      |   | December 31, 2012 |      |   |
| +200                                                                      | \$5,232                                     | 1.4  | % | \$9,396           | 2.6  | % |
| +100                                                                      | 2,945                                       | 0.8  | % | 4,893             | 1.4  | % |
| -100                                                                      | (5,463)                                     | -1.5 | % | (8,387)           | -2.4 | % |

Immediate Change in Interest Rates (basis points)

|      |           |      |   |           |      |   |
|------|-----------|------|---|-----------|------|---|
| +200 | \$15,524  | 4.3  | % | \$26,050  | 7.3  | % |
| +100 | 9,426     | 2.6  | % | 14,449    | 4.1  | % |
| -100 | (18,413 ) | -5.1 | % | (25,931 ) | -7.3 | % |

To analyze the impact of changes in interest rates in a more realistic manner, non-parallel interest rate scenarios are also simulated. These non-parallel interest rate scenarios indicate that net interest income may decrease from the base case scenario should the yield curve flatten or become inverted for a period of time. Conversely, if the yield curve should steepen, net interest income may increase.

## Other Market Risks

In addition to interest rate risk, we are exposed to other forms of market risk in our normal business transactions. Foreign currency and foreign exchange contracts expose us to a small degree of foreign currency risk. These transactions are primarily executed on behalf of customers. Our trust and asset management income are at risk to fluctuations in the market values of underlying assets, particularly debt and equity securities. Also, our share-based compensation expense is dependent on the fair value of our stock options and restricted stock at the date of grant. The fair value of both stock options and restricted stock is impacted by the market price of the Parent's common stock on the date of grant and is at risk to changes in equity markets, general economic conditions, and other factors.

## Liquidity Risk Management

The objective of our liquidity risk management process is to manage cash flow and liquidity in an effort to provide continuous access to sufficient, reasonably priced funds. Funding requirements are impacted by loan originations and refinancings, deposit growth, liability issuances and settlements, and off-balance sheet funding commitments. We consider and comply with various regulatory 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 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.

In an effort to satisfy our liquidity needs, we actively manage our assets and liabilities. We have immediate liquid resources in cash and noninterest-bearing deposits and funds sold. The potential sources of short-term liquidity include interest-bearing deposits as well as the ability to sell certain assets including available-for-sale investment securities. Short-term liquidity is further enhanced by our ability to sell loans in the secondary market and to secure borrowings from the FRB and FHLB. Short-term liquidity is also generated from securities sold under agreements to repurchase and funds purchased. Deposits have historically provided us with a long-term source of stable and relatively lower cost source of funding. Additional funding is available through the issuance of long-term debt.

Maturities and payments on outstanding loans also provide a steady flow of funds. Additionally, as of June 30, 2013, investment securities with a carrying value of \$239.0 million were due to contractually mature in one year or less. Liquidity is further enhanced by our ability to pledge loans to access secured borrowings from the FHLB and FRB. As of June 30, 2013, we could have borrowed an additional \$1.0 billion from the FHLB and an additional \$679.3 million from the FRB based on the amount of collateral pledged.

We continued to maintain a strong liquidity position throughout the first six months of 2013. As of June 30, 2013, cash and cash equivalents were \$470.9 million, the carrying value of our available-for-sale investment securities were \$2.8 billion, and total deposits were \$11.4 billion. As of June 30, 2013, we continued to maintain our excess liquidity primarily in mortgage-backed securities issued by Ginnie Mae, state and municipal bond holdings, and in debt securities issued by the U.S. Treasury. As of June 30, 2013, our available-for-sale investment securities portfolio was comprised of securities with an average base duration of approximately three years.

## Capital Management

We actively manage capital, commensurate with our risk profile, to enhance shareholder value. We also seek to maintain capital levels for the Company and the Bank at amounts in excess of the regulatory "well-capitalized" thresholds. Periodically, we may respond to market conditions by implementing changes to our overall balance sheet positioning to manage our capital position.

The Company and the Bank are each subject to regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can cause certain mandatory and discretionary actions by regulators that, if undertaken, could have a material effect on our financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Company and the Bank must meet specific capital guidelines that involve quantitative and qualitative measures. These measures were established by regulation to ensure capital adequacy. As of June 30, 2013, the Company and the Bank were considered “well capitalized” under this regulatory framework. The Company’s regulatory capital ratios are presented in Table 21 below. There have been no conditions or events since June 30, 2013 that management believes have changed either the Company’s or the Bank’s capital classifications.

As of June 30, 2013, shareholders' equity was \$986.4 million, a decrease of \$35.3 million or 3% from December 31, 2012. For the first six months of 2013, other comprehensive loss of \$55.9 million, cash dividends paid of \$40.4 million, and common stock repurchased of \$24.0 million were partially offset by earnings of \$73.7 million, common stock issuances of \$8.5 million, and shared-based compensation of \$2.7 million. Other comprehensive loss of \$55.9 million for the first six months of 2013 was primarily due to a \$47.3 million after-tax decrease in the fair value of our available-for-sale investment securities. Should market interest rates continue to increase during the remainder of 2013, we may experience further reductions in the fair value of our available-for-sale investment securities, which may result in lower levels of capital. During the second quarter of 2013, we also reclassified at fair value approximately \$255.0 million in available-for-sale investment securities to the held-to-maturity category. The related unrealized after-tax losses at the date of transfer of approximately \$5.1 million remained in accumulated other comprehensive income to be amortized over the estimated remaining life of the securities as an adjustment of yield. For the first six months of 2013, included in the amount of common stock repurchased were 441,649 shares repurchased under our share repurchase program. These shares were repurchased at an average cost per share of \$48.98 and a total cost of \$21.6 million. From the beginning of our share repurchase program in July 2001 through June 30, 2013, we repurchased a total of 50.7 million shares of common stock and returned a total of \$1.8 billion to our shareholders at an average cost of \$36.44 per share. As of June 30, 2013, remaining buyback authority under our share repurchase program was \$47.9 million of the total \$1.9 billion repurchase amount authorized by our Board of Directors.

From July 1, 2013 through July 16, 2013, the Parent repurchased an additional 55,000 shares of common stock at an average cost of \$53.25 per share for a total of \$2.9 million. Remaining buyback authority under our share repurchase program was \$45.0 million as of July 16, 2013. The actual amount and timing of future share repurchases, if any, will depend on market and economic conditions, regulatory rules, applicable SEC rules, and various other factors.

In July 2013, the Parent's Board of Directors declared a quarterly cash dividend of \$0.45 per share on the Parent's outstanding shares. The dividend will be payable on September 16, 2013 to shareholders of record at the close of business on August 30, 2013.

We continue to evaluate the potential impact that regulatory rules may have on our liquidity and capital management strategies, including Basel III and those required under the Dodd-Frank Act. See the "Regulatory Initiatives Related to Liquidity, Capital, and Stress Testing" section below for further discussion on the potential impact that these regulatory rules may have on our liquidity and capital requirements.

Table 21 presents our regulatory capital and ratios as of June 30, 2013 and December 31, 2012.

| Regulatory Capital and Ratios                 | June 30,<br>2013 | Table 21<br>December 31,<br>2012 |
|-----------------------------------------------|------------------|----------------------------------|
| (dollars in thousands)                        |                  |                                  |
| Regulatory Capital                            |                  |                                  |
| Shareholders' Equity                          | \$986,368        | \$1,021,665                      |
| Less: Goodwill                                | 31,517           | 31,517                           |
| Postretirement Benefit Liability Adjustments  | 1,344            | 1,442                            |
| Net Unrealized Gains on Investment Securities | 3,564            | 59,777                           |
| Other                                         | 2,564            | 2,326                            |
| Tier 1 Capital                                | 947,379          | 926,603                          |
| Allowable Reserve for Credit Losses           | 76,917           | 72,580                           |
| Total Regulatory Capital                      | \$1,024,296      | \$999,183                        |
| Risk-Weighted Assets                          | \$6,099,770      | \$5,744,722                      |

Key Regulatory Capital Ratios

|                       |       |         |   |
|-----------------------|-------|---------|---|
| Tier 1 Capital Ratio  | 15.53 | % 16.13 | % |
| Total Capital Ratio   | 16.79 | 17.39   |   |
| Tier 1 Leverage Ratio | 6.95  | 6.83    |   |

## Regulatory Initiatives Related to Liquidity, Capital, and Stress Testing

### Basel III

On July 2, 2013, the FRB approved the final rules implementing the Basel Committee on Banking Supervision's ("BCBS") capital guidelines for U.S. banks. Under the final rules, minimum requirements will increase for both the quantity and quality of capital held by the Company. The rules include a new common equity Tier 1 capital to risk-weighted assets ratio of 4.5% and a common equity Tier 1 capital conservation buffer of 2.5% of risk-weighted assets. The final rules also raise the minimum ratio of Tier 1 capital to risk-weighted assets from 4.0% to 6.0% and require a minimum leverage ratio of 4.0%. The final rules also implement strict eligibility criteria for regulatory capital instruments. On July 9, 2013, the FDIC also approved, as an interim final rule, the regulatory capital requirements for U.S. banks, following the actions of the FRB. The FDIC's rule is identical in substance to the final rules issued by the FRB.

The phase-in period for the final rules will begin for the Company on January 1, 2015, with full compliance with all of the final rule's requirements phased in over a multi-year schedule. Management is currently evaluating the provisions of the final rules and their expected impact to the Company.

### Stress Testing

The Dodd-Frank Act also requires federal banking agencies to issue regulations that require banks with total consolidated assets of more than \$10.0 billion to conduct and publish self-administered annual stress tests to assess the potential impact of different scenarios on the consolidated earnings and capital of each bank and certain related items over a nine-quarter forward-looking planning horizon, taking into account all relevant exposures and activities. On October 9, 2012, the FRB published final rules implementing the stress testing requirements for banks with total consolidated assets of more than \$10.0 billion, but delayed the effective date until October 2013. The final stress testing rules set forth the timing and type of stress test activities, as well as rules governing controls, oversight and disclosure. We will be required to submit results from our self-administered annual stress tests by March 31, 2014.

### Operational Risk

Operational risk represents the risk of loss resulting from our operations, including, but not limited to, the risk of fraud by employees or persons outside the Company, errors relating to transaction processing and technology, failure to adhere to compliance requirements, business continuation and disaster recovery, and the risk of cyber security attacks. We are also exposed to operational risk through our outsourcing arrangements, and the effect that changes in circumstances or capabilities of our outsourcing vendors can have on our ability to continue to perform operational functions necessary to our business. The risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. Operational risk is inherent in all business activities, and management of this risk is important to the achievement of Company goals and objectives.

Our Operating Risk Committee (the "ORC") provides oversight and assesses the most significant operational risks facing the Company. We have developed a framework that provides for a centralized operating risk management function through the ORC, supplemented by business unit responsibility for managing operational risks specific to their business units. Our internal audit department also validates the system of internal controls through ongoing risk-based audit procedures and reports on the effectiveness of internal controls to executive management and the Audit and Risk Committee of the Board of Directors.

We continuously strive to strengthen our system of internal controls to improve the oversight of operational risk. While we believe that internal controls have been designed to minimize operational risks, there is no assurance that business disruption or operational losses will not occur. On an ongoing basis, management reassesses operational risks, implements appropriate process changes, and invests in enhancements to our systems of internal controls.

## European Debt Crisis

In recent years, certain European countries have experienced severe credit deterioration. We continue to monitor the debt crisis in Europe and the potential direct and indirect impact it may have on us. As of June 30, 2013, we had no direct exposure to sovereign European governments and our non-sovereign European exposures posed a low risk of loss to the Company. However, the U.S. and Hawaii economies and our customers may be adversely affected by future developments arising from the debt crisis in Europe, and, if our customers are, or the Hawaii economy is, so affected, it may have a negative effect on our business, financial condition, and results of operations.

## Off-Balance Sheet Arrangements, Credit Commitments, and Contractual Obligations

### Off-Balance Sheet Arrangements

We hold interests in several unconsolidated variable interest entities (“VIEs”). These unconsolidated VIEs are primarily low-income housing partnerships. 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 VIE. We have determined that the Company is not the primary beneficiary of these entities. As a result, we do not consolidate these VIEs.

### Credit Commitments and Contractual Obligations

Our credit commitments and contractual obligations have not changed materially since previously reported in our Annual Report on Form 10-K for the year ended December 31, 2012.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

See the “Market Risk” section of MD&A.

### 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, 2013. 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 U.S. Securities and Exchange Commission’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 Chief Executive Officer and Chief Financial Officer concluded that the Company’s disclosure controls and procedures were effective as of June 30, 2013.

#### 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, 2013 that have materially affected or are reasonably likely to materially affect the Company’s internal control over financial reporting.

## Part II - Other Information

## Item 1A. Risk Factors

There are no material changes from the risk factors set forth under Part I, Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2012.

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The Parent’s repurchases of its common stock during the second quarter of 2013 were as follows:

## Issuer Purchases of Equity Securities

| Period             | Total Number of<br>Shares<br>Purchased <sup>1</sup> | Average Price<br>Paid Per Share | Total Number of Shares<br>Purchased as Part of<br>Publicly Announced<br>Plans or Programs | Approximate Dollar Value<br>of Shares that May Yet<br>Be Purchased Under the<br>Plans or Programs <sup>2</sup> |
|--------------------|-----------------------------------------------------|---------------------------------|-------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|
| April 1 - 30, 2013 | 82,886                                              | \$48.01                         | 70,000                                                                                    | \$ 59,511,215                                                                                                  |
| May 1 - 31, 2013   | 85,647                                              | 49.58                           | 84,500                                                                                    | 55,321,337                                                                                                     |
| June 1 - 30, 2013  | 150,149                                             | 49.52                           | 150,149                                                                                   | 47,886,341                                                                                                     |
| Total              | 318,682                                             | \$49.14                         | 304,649                                                                                   |                                                                                                                |

<sup>1</sup> During the second quarter of 2013, 14,033 shares were purchased from employees and/or directors in connection with stock swaps, shares purchased for a deferred compensation plan, and income tax withholdings related to the vesting of restricted stock. These shares were not purchased as part of the publicly announced program. The shares were purchased at the closing price of the Parent’s common stock on the dates of purchase.

<sup>2</sup> The share repurchase program was first announced in July 2001. As of June 30, 2013, \$47.9 million remained of the total \$1.9 billion total repurchase amount authorized by the Parent’s Board of Directors under the share repurchase program. The program has no set expiration or termination date.

## 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.

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 22, 2013

Bank of Hawaii Corporation

By: /s/ Peter S. Ho  
Peter S. Ho  
Chairman of the Board,  
Chief Executive Officer, and  
President

By: /s/ Kent T. Lucien  
Kent T. Lucien  
Chief Financial Officer

Exhibit Index

Exhibit Number

|      |                                                                                                                                                                               |
|------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 31.1 | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) Under the Securities Exchange Act of 1934                                                                 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) Under the Securities Exchange Act of 1934                                                                 |
| 32   | Certification of Chief Executive Officer and 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  | Interactive Data File                                                                                                                                                         |
| 75   |                                                                                                                                                                               |