

CENTRAL PACIFIC FINANCIAL CORP  
Form 10-Q  
August 02, 2017

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, 2017

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 001-31567

CENTRAL PACIFIC FINANCIAL CORP.  
(Exact name of registrant as specified in its charter)

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

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

(808) 544-0500  
(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 (§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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company   
Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 7(a)(2)(B) of the Securities Act .

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

The number of shares outstanding of registrant's common stock, no par value, on July 27, 2017 was 30,439,187 shares.

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CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES  
Form 10-Q

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## PART I. FINANCIAL INFORMATION

### Forward-Looking Statements

This document may contain forward-looking statements concerning projections of revenues, income/loss, earnings/loss per share, capital expenditures, dividends, capital structure, net interest margin or other financial items, concerning plans and objectives of management for future operations, concerning future economic performance, or concerning any of the assumptions underlying or relating to any of the foregoing. Forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts, and may include the words "believes," "plans," "intends," "expects," "anticipates," "forecasts," "hopes," "should," "estimates" or words of similar meaning. While we believe that our forward-looking statements and the assumptions underlying them are reasonably based, such statements and assumptions are by their nature subject to risks and uncertainties, and thus could later prove to be inaccurate or incorrect. Accordingly, actual results could materially differ from projections for a variety of reasons, to include, but not be limited to: adverse changes in the financial performance and/or condition of our borrowers and, as a result, increased loan delinquency rates, deterioration in asset quality, and losses in our loan portfolio; the impact of local, national, and international economies and events (including natural disasters such as wildfires, tsunamis, storms and earthquakes) on the Company's business and operations and on tourism, the military, and other major industries operating within the Hawaii market and any other markets in which the Company does business; deterioration or malaise in domestic economic conditions, including any further destabilization in the financial industry and deterioration of the real estate market, as well as the impact of declining levels of consumer and business confidence in the state of the economy in general and in financial institutions in particular; changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements; the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act, changes in capital standards, other regulatory reform, including but not limited to regulations promulgated by the Consumer Financial Protection Bureau, government-sponsored enterprise reform, and any related rules and regulations on our business operations and competitiveness; the costs and effects of legal and regulatory developments, including the resolution of legal proceedings or regulatory or other governmental inquiries and the results of regulatory examinations or reviews; ability to successfully implement our initiatives to lower our efficiency ratio; the ability to address any material weakness in our internal controls over financial reporting or disclosure controls and procedures; the effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve System; inflation, interest rate, securities market and monetary fluctuations; negative trends in our market capitalization and adverse changes in the price of the Company's common stock; political instability; acts of war or terrorism; changes in consumer spending, borrowings and savings habits; failure to maintain effective internal control over financial reporting or disclosure controls and procedures; technological changes; changes in the competitive environment among financial holding companies and other financial service providers; the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters; our ability to attract and retain key personnel; changes in our organization, compensation and benefit plans; and our success at managing the risks involved in the foregoing items. For further information on factors that could cause actual results to materially differ from projections, please see the Company's publicly available Securities and Exchange Commission filings, including the Company's Form 10-K for the last fiscal year and, in particular, the discussion of "Risk Factors" set forth therein. The Company does not update any of its forward-looking statements except as required by law.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS (Unaudited)

| (dollars in thousands)   | June 30,<br>2017 | December<br>31,<br>2016 |
|--|------------------|-------------------------|
| <b>Assets</b>  |                  |                         |
| Cash and due from banks  | \$85,975         | \$75,272                |
| Interest-bearing deposits in other banks   | 54,576           | 9,069                   |
| Investment securities:   |                  |                         |
| Available-for-sale, at fair value  | 1,315,895        | 1,243,847               |
| Held-to-maturity, at amortized cost; fair value of: \$203,334 at June 30, 2017 and \$214,366 at December 31, 2016                                  | 204,588          | 217,668                 |
| Total investment securities  | 1,520,483        | 1,461,515               |
| Loans held for sale  | 13,288           | 31,881                  |
| Loans and leases   | 3,591,735        | 3,524,890               |
| Allowance for loan and lease losses  | (52,828)         | (56,631)                |
| Net loans and leases   | 3,538,907        | 3,468,259               |
| Premises and equipment, net  | 49,252           | 48,258                  |
| Accrued interest receivable  | 15,636           | 15,675                  |
| Investment in unconsolidated subsidiaries  | 6,189            | 6,889                   |
| Other real estate owned  | 1,008            | 791                     |
| Mortgage servicing rights  | 15,932           | 15,779                  |
| Core deposit premium   | 3,343            | 4,680                   |
| Bank-owned life insurance  | 156,053          | 155,593                 |
| Federal Home Loan Bank stock   | 6,492            | 11,572                  |
| Other assets   | 66,001           | 79,003                  |
| Total Assets   | \$5,533,135      | \$5,384,236             |
| <b>Liabilities</b>   |                  |                         |
| Deposits:  |                  |                         |
| Noninterest-bearing demand   | \$1,383,754      | \$1,265,246             |
| Interest-bearing demand  | 917,956          | 862,991                 |
| Savings and money market   | 1,453,108        | 1,390,600               |
| Time   | 1,131,564        | 1,089,364               |
| Total deposits   | 4,886,382        | 4,608,201               |
| Short-term borrowings  | —                | 135,000                 |
| Long-term debt   | 92,785           | 92,785                  |
| Other liabilities  | 41,013           | 43,575                  |
| Total Liabilities  | 5,020,180        | 4,879,561               |
| <b>Equity</b>  |                  |                         |
| Preferred stock, no par value, authorized 1,000,000 shares; issued and outstanding: none at June 30, 2017 and December 31, 2016                    | —                | —                       |
| Common stock, no par value, authorized 185,000,000 shares; issued and outstanding: 30,514,799 at June 30, 2017 and 30,796,243 at December 31, 2016 | 519,383          | 530,932                 |

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|  |             |             |
|--|-------------|-------------|
| Surplus                                | 84,592      | 84,180      |
| Accumulated deficit                    | (94,269 )   | (108,941 )  |
| Accumulated other comprehensive income | 3,224       | (1,521 )    |
| Total Shareholders' Equity             | 512,930     | 504,650     |
| Non-controlling interest               | 25          | 25          |
| Total Equity                           | 512,955     | 504,675     |
| Total Liabilities and Equity           | \$5,533,135 | \$5,384,236 |

See accompanying notes to consolidated financial statements.

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CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)

|  | Three Months Ended |          | Six Months Ended |          |
|--|--------------------|----------|------------------|----------|
|  | June 30,           |          | June 30,         |          |
| (dollars in thousands, except per share data)              | 2017               | 2016     | 2017             | 2016     |
| Interest income:   |                    |          |                  |          |
| Interest and fees on loans and leases                      | \$35,531           | \$32,878 | \$70,488         | \$64,671 |
| Interest and dividends on investment securities:           |                    |          |                  |          |
| Taxable interest   | 8,481              | 7,953    | 16,616           | 16,349   |
| Tax-exempt interest  | 974                | 995      | 1,953            | 1,991    |
| Dividends  | 12                 | 10       | 24               | 20       |
| Interest on deposits in other banks                        | 61                 | 11       | 135              | 28       |
| Dividends on Federal Home Loan Bank stock                  | 21                 | 23       | 77               | 60       |
| Total interest income                                      | 45,080             | 41,870   | 89,293           | 83,119   |
| Interest expense:  |                    |          |                  |          |
| Interest on deposits:                                      |                    |          |                  |          |
| Demand   | 154                | 123      | 294              | 234      |
| Savings and money market                                   | 259                | 269      | 516              | 532      |
| Time   | 2,136              | 957      | 3,853            | 1,855    |
| Interest on short-term borrowings                          | 46                 | 177      | 77               | 227      |
| Interest on long-term debt                                 | 856                | 735      | 1,669            | 1,451    |
| Total interest expense                                     | 3,451              | 2,261    | 6,409            | 4,299    |
| Net interest income  | 41,629             | 39,609   | 82,884           | 78,820   |
| Provision (credit) for loan and lease losses               | (2,282 )           | (1,382 ) | (2,362 )         | (2,129 ) |
| Net interest income after credit for loan and lease losses | 43,911             | 40,991   | 85,246           | 80,949   |
| Other operating income:                                    |                    |          |                  |          |
| Mortgage banking income                                    | 1,957              | 1,423    | 3,900            | 2,663    |
| Service charges on deposit accounts                        | 2,120              | 1,908    | 4,156            | 3,872    |
| Other service charges and fees                             | 3,053              | 3,028    | 5,801            | 5,795    |
| Income from fiduciary activities                           | 964                | 857      | 1,828            | 1,697    |
| Equity in earnings of unconsolidated subsidiaries          | 151                | 184      | 212              | 274      |
| Fees on foreign exchange                                   | 130                | 126      | 293              | 274      |
| Investment securities gains (losses)                       | (1,640 )           | —        | (1,640 )         | —        |
| Income from bank-owned life insurance                      | 583                | 1,232    | 1,700            | 1,857    |
| Loan placement fees  | 146                | 133      | 280              | 179      |
| Net gain on sales of foreclosed assets                     | 84                 | 241      | 186              | 549      |
| Other  | 322                | 805      | 1,168            | 1,433    |
| Total other operating income                               | 7,870              | 9,937    | 17,884           | 18,593   |
| Other operating expense:                                   |                    |          |                  |          |
| Salaries and employee benefits                             | 17,983             | 17,850   | 35,370           | 34,787   |
| Net occupancy  | 3,335              | 3,557    | 6,749            | 6,871    |
| Equipment  | 967                | 769      | 1,809            | 1,580    |
| Amortization of core deposit premium                       | 669                | 668      | 1,337            | 1,337    |
| Communication expense                                      | 891                | 919      | 1,791            | 1,878    |
| Legal and professional services                            | 1,987              | 1,723    | 3,779            | 3,336    |
| Computer software expense                                  | 2,190              | 2,222    | 4,442            | 4,926    |
| Advertising expense  | 390                | 433      | 782              | 1,067    |
| Foreclosed asset expense                                   | 63                 | 49       | 99               | 64       |
| Other  | 3,860              | 4,270    | 7,637            | 7,980    |

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|                                   |            |            |            |            |
|-----------------------------------|------------|------------|------------|------------|
| Total other operating expense     | 32,335     | 32,460     | 63,795     | 63,826     |
| Income before income taxes        | 19,446     | 18,468     | 39,335     | 35,716     |
| Income tax expense                | 7,421      | 6,331      | 14,231     | 12,398     |
| Net income                        | \$12,025   | \$12,137   | \$25,104   | \$23,318   |
| Per common share data:            |            |            |            |            |
| Basic earnings per common share   | \$0.39     | \$0.39     | \$0.82     | \$0.75     |
| Diluted earnings per common share | \$0.39     | \$0.39     | \$0.81     | \$0.74     |
| Cash dividends declared           | \$0.18     | \$0.14     | \$0.34     | \$0.28     |
| Shares used in computation:       |            |            |            |            |
| Basic shares                      | 30,568,247 | 31,060,593 | 30,641,163 | 31,162,013 |
| Diluted shares                    | 30,803,723 | 31,262,525 | 30,879,923 | 31,359,568 |

See accompanying notes to consolidated financial statements.



CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

|  | Three Months      |          | Six Months Ended |          |
|--|-------------------|----------|------------------|----------|
|  | Ended<br>June 30, |          | June 30,         |          |
| (dollars in thousands)                                 | 2017              | 2016     | 2017             | 2016     |
| Net income   | \$12,025          | \$12,137 | \$25,104         | \$23,318 |
| Other comprehensive income, net of tax:                |                   |          |                  |          |
| Net change in unrealized gain on investment securities | 2,795             | 5,866    | 4,919            | 17,719   |
| Minimum pension liability adjustment                   | 190               | 249      | (174 )           | 499      |
| Total other comprehensive income, net of tax           | 2,985             | 6,115    | 4,745            | 18,218   |
| Comprehensive income                                   | \$15,010          | \$18,252 | \$29,849         | \$41,536 |

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY (Unaudited)

|  | Common<br>Shares<br>Outstanding | Preferred<br>Stock | Common<br>Stock | Surplus  | Accumulated<br>Deficit | Accumulated<br>Other<br>Comprehensive<br>Income | Non-<br>Controlling<br>Interest | Total     |
|--|---------------------------------|--------------------|-----------------|----------|------------------------|---|---------------------------------|-----------|
| (dollars in thousands, except per share data)  |                                 |                    |                 |          |                        |   |                                 |           |
| Balance at December 31, 2016   | 30,796,243                      | \$ —               | —               | \$84,180 | \$(108,941)            | \$ (1,521)                                      | \$ 25                           | \$504,675 |
| Net income   | —                               | —                  | —               | —        | 25,104                 | —   | —                               | 25,104    |
| Other comprehensive income   | —                               | —                  | —               | —        | —                      | 4,745   | —                               | 4,745     |
| Cash dividends (\$0.34 per share)  | —                               | —                  | —               | —        | (10,432)               | —   | —                               | (10,432)  |
| 10,620 net shares of common stock purchased by directors' deferred compensation plan | —                               | —                  | (341)           | —        | —                      | —   | —                               | (341)     |
| 362,371 shares of common stock repurchased and other related costs                   | (362,371)                       | —                  | (11,208)        | —        | —                      | —   | —                               | (11,208)  |
| Share-based compensation   | 80,927                          | —                  | —               | 412      | —                      | —   | —                               | 412       |
| Non-controlling interest   | —                               | —                  | —               | —        | —                      | —   | —                               | —         |
| Balance at June 30, 2017   | 30,514,799                      | \$ —               | —               | \$84,592 | \$(94,269)             | \$ 3,224  | \$ 25                           | \$512,955 |
| Balance at December 31, 2015   | 31,361,452                      | \$ —               | —               | \$82,847 | \$(137,314)            | \$ 203  | \$ 25                           | \$494,639 |
| Net income   | —                               | —                  | —               | —        | 23,318                 | —   | —                               | 23,318    |
| Other comprehensive income   | —                               | —                  | —               | —        | —                      | 18,218  | —                               | 18,218    |
| Cash dividends (\$0.28 per share)  | —                               | —                  | —               | —        | (8,734)                | —   | —                               | (8,734)   |
| 5,000 net shares of common stock purchased by directors' deferred compensation plan  | —                               | —                  | (99)            | —        | —                      | —   | —                               | (99)      |
| 492,922 shares of common stock repurchased and other related costs                   | (492,922)                       | —                  | (10,544)        | —        | —                      | —   | —                               | (10,544)  |
| Share-based compensation   | 168,365                         | —                  | 199             | 635      | —                      | —   | —                               | 834       |
| Non-controlling interest   | —                               | —                  | —               | —        | —                      | —   | (16)                            | (16)      |
| Balance at June 30, 2016   | 31,036,895                      | \$ —               | —               | \$83,482 | \$(122,730)            | \$ 18,421                                       | \$ 9                            | \$517,616 |

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

|   | Six Months Ended |           |
|---|------------------|-----------|
|   | June 30,         |           |
| (dollars in thousands)  | 2017             | 2016      |
| Cash flows from operating activities:   |                  |           |
| Net income  | \$25,104         | \$23,318  |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |           |
| Provision (credit) for loan and lease losses                                      | (2,362 )         | (2,129 )  |
| Depreciation and amortization   | 3,150            | 2,974     |
| Write down of other real estate, net of gain on sale                              | (165 )           | (222 )    |
| Amortization of core deposit premium and mortgage servicing rights                | 2,404            | 4,601     |
| Net amortization of investment securities   | 5,826            | 5,801     |
| Share-based compensation  | 412              | 635       |
| Net loss on investment securities   | 1,640            | —         |
| Net gain on sales of residential loans  | (2,396 )         | (3,311 )  |
| Proceeds from sales of loans held for sale  | 168,624          | 193,848   |
| Originations of loans held for sale   | (147,635 )       | (186,349) |
| Equity in earnings of unconsolidated subsidiaries                                 | (212 )           | (274 )    |
| Net increase in cash surrender value of bank-owned life insurance                 | (2,170 )         | (1,994 )  |
| Deferred income taxes   | 13,648           | 12,398    |
| Net tax benefits from share-based compensation                                    | 583              | —         |
| Net change in other assets and liabilities  | (8,279 )         | 1,373     |
| Net cash provided by operating activities   | 58,172           | 50,669    |
| Cash flows from investing activities:   |                  |           |
| Proceeds from maturities of and calls on investment securities available for sale | 86,372           | 81,894    |
| Proceeds from sales of investment securities available for sale                   | 96,019           | —         |
| Purchases of investment securities available for sale                             | (253,372 )       | (46,215 ) |
| Proceeds from maturities of and calls on investment securities held to maturity   | 12,715           | 13,289    |
| Net loan proceeds (originations)  | (17,715 )        | (115,771) |
| Purchases of loan portfolios  | (50,725 )        | (77,702 ) |
| Proceeds from sale of other real estate   | 102              | 1,789     |
| Proceeds from bank-owned life insurance   | 1,710            | 1,283     |
| Purchases of premises and equipment   | (4,144 )         | (2,183 )  |
| Net return of capital from unconsolidated subsidiaries                            | 455              | 412       |
| Contributions to unconsolidated subsidiaries                                      | —                | (5 )      |
| Net (purchases) proceeds from redemption of FHLB stock                            | 5,080            | (6,612 )  |
| Net cash used in investing activities   | (123,503 )       | (149,821) |
| Cash flows from financing activities:   |                  |           |
| Net increase (decrease) in deposits   | 278,181          | (28,297 ) |
| Net (decrease) increase in short-term borrowings                                  | (135,000 )       | 157,000   |
| Cash dividends paid on common stock   | (10,432 )        | (8,734 )  |
| Repurchases of common stock and other related costs                               | (11,208 )        | (10,544 ) |
| Net proceeds from issuance of common stock and stock option exercises             | —                | 199       |
| Net cash provided by financing activities   | 121,541          | 109,624   |
| Net increase in cash and cash equivalents   | 56,210           | 10,472    |
| Cash and cash equivalents at beginning of period                                  | 84,341           | 80,194    |
| Cash and cash equivalents at end of period  | \$140,551        | \$90,666  |

Supplemental disclosure of cash flow information:

Cash paid during the period for:

|              |         |         |
|--------------|---------|---------|
| Interest     | \$5,461 | \$3,986 |
| Income taxes | 4,000   | —       |

Cash received during the period for:

|              |   |       |
|--------------|---|-------|
| Income taxes | — | 1,605 |
|--------------|---|-------|

Supplemental disclosure of non-cash investing and financing activities:

|  |     |     |
|--|-----|-----|
| Net change in common stock held by directors' deferred compensation plan | 341 | 99  |
| Net reclassification of loans to other real estate                       | 154 | 637 |

See accompanying notes to consolidated financial statements.

CENTRAL PACIFIC FINANCIAL CORP. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements of Central Pacific Financial Corp. and Subsidiaries (herein referred to as the "Company," "we," "us" or "our") 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, certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to such rules and regulations.

These interim condensed consolidated financial statements and notes should be read in conjunction with the Company's consolidated financial statements and notes thereto filed on Form 10-K for the fiscal year ended December 31, 2016. In the opinion of management, all adjustments necessary for a fair presentation have been made and include all normal recurring adjustments. Interim results of operations are not necessarily indicative of results to be expected for the year.

Principles of Consolidation

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

In December 2015, we acquired a 50% ownership interest in a mortgage loan origination and brokerage company, One Hawaii HomeLoans, LLC. The bank concluded that the investment meets the consolidation requirements under Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 810, "Consolidation." The bank concluded that the entity meets the definition of a variable interest entity and that we are the primary beneficiary of the variable interest entity. Accordingly, the investment has been consolidated into our financial statements.

We have 50% ownership interests in four other mortgage loan origination and brokerage companies which are accounted for using the equity method and are included in investment in unconsolidated subsidiaries: Pacific Access Mortgage, LLC, Gentry HomeLoans, LLC, Haseko HomeLoans, LLC and Island Pacific HomeLoans, LLC.

We also have non-controlling equity investments in affiliates that are accounted for under the cost method and are included in investment in unconsolidated subsidiaries.

Our investments in unconsolidated subsidiaries accounted for under the equity and cost methods were \$0.4 million and \$5.8 million, respectively, at June 30, 2017 and \$0.7 million and \$6.2 million, respectively, at December 31, 2016. Our policy for determining impairment of these investments includes an evaluation of whether a loss in value of an investment is other than temporary. Evidence of a loss in value includes absence of an ability to recover the carrying amount of the investment or the inability of the investee to sustain an earnings capacity which would justify the carrying amount of the investment. We perform impairment tests whenever indicators of impairment are present. If the value of an investment declines and it is considered other than temporary, the investment is written down to its respective fair value in the period in which this determination is made.

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

#### Consolidated Statements of Income Reclassification

On December 31, 2016, the Company elected to reclassify loan servicing fees, amortization of mortgage servicing rights, net gain on sale of residential mortgage loans, and unrealized gain (loss) on interest rate locks into a single line item called "mortgage banking income" in the Company's consolidated statements of income. Loan servicing fees and net gain on sale of residential mortgage loans were previously recorded in its own line in the other operating income section of the consolidated statements of income, while unrealized gain (loss) on interest rate locks was included as a component of other operating income - other. The amortization of mortgage servicing rights was previously recorded as a component of amortization and impairment of other intangible assets in the other operating expense section of the Company's consolidated statements of income. The components of mortgage banking income are disclosed in Note 12 - Mortgage Banking Income to the consolidated

financial statements. The Company believes the reclassification provides a better presentation of revenues and costs of our mortgage banking activities. Prior year comparative financial statements have been adjusted retrospectively.

## 2. RECENT ACCOUNTING PRONOUNCEMENTS

In March 2016, the FASB issued ASU 2016-09, "Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." ASU 2016-09 simplifies the accounting for share-based payments. Specifically, the amendments: 1) require entities to record all excess tax benefits and tax deficiencies as an income tax benefit or expense in the income statement; 2) change the classification of excess tax benefits to an operating activity in the statement of cash flows; 3) allows entities to elect an accounting policy to either estimate the number of forfeitures or account for forfeitures when they occur; and 4) allows entities to withhold up to the maximum individual statutory tax rate without classifying the awards as a liability. We adopted ASU 2016-09 effective January 1, 2017 and elected to recognize forfeitures as they occur. The Company's adoption was prospective, therefore, prior periods have not been adjusted. The adoption of ASU 2016-09 could result in greater volatility to reported income tax expense related to excess tax benefits and tax deficiencies for employee share-based payments. The volatility results from changes in the share price and timing of exercise of share options and vesting of share awards. For the six months ended June 30, 2017, the adoption of ASU 2016-09 resulted in a decrease to the provision for income taxes due to the tax benefit from the vesting of restricted stock units.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)." ASU 2014-09 requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. This ASU will replace most existing revenue recognition guidance in GAAP when it becomes effective. ASU 2014-09 was initially effective for the Company's reporting period beginning on January 1, 2017. However, in August 2015, the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date" which defers the effective date by one year. For financial reporting purposes, the standard allows for either a full retrospective or modified retrospective adoption. The FASB has also issued additional updates to provide further clarification to specific implementation issues associated with ASU 2014-09. These updates include ASU 2016-08, "Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations," ASU 2016-10, "Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing," ASU 2016-12, "Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients," and ASU 2016-20 "Technical Corrections and Improvements to Topic 606." Our revenue is comprised of net interest income on financial assets and financial liabilities, which is explicitly excluded from the scope of ASU 2014-09, and other operating income. We expect that ASU 2014-09 may require us to change how we recognize certain recurring revenue streams; however, we do not expect these changes to have a material impact on our financial statements. We continue to evaluate the impact of ASU 2014-09 on components of other operating income. This includes reviewing the contracts potentially impacted by the ASU in revenue streams such as trust and asset management fees, deposit related fees, and commissions income. Additionally, we continue to follow implementation issues relevant to the banking industry, and consider the disclosure requirements upon implementation. We expect to adopt the standard beginning January 1, 2018 under the modified retrospective approach with a cumulative effect adjustment to opening retained earnings, if such adjustment is deemed to be significant.

In January 2016, the FASB issued ASU 2016-01, "Financial Instruments-Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities." ASU 2016-01 changes the income statement impact of equity investments, and the recognition of changes in fair value of financial liabilities when the fair value option is selected. ASU 2016-01 is effective for the Company's reporting period beginning January 1, 2018. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, "Leases (Topic 842)." ASU 2016-02 increases transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. The new standard establishes a right-of-use model (ROU) that requires a lessee to recognize a ROU asset and lease liability on the balance sheet for all leases with a term of longer than 12 months. ASU 2016-02 is effective for the Company's reporting period beginning January 1, 2019 and must be applied using the modified retrospective approach. Based on preliminary evaluation, the new pronouncement will not have a material impact on our consolidated financial statements as the projected minimum lease payments under existing leases subject to the new pronouncement are less than one percent of our current total assets as of December 31, 2016.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments-Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments." The ASU requires an organization to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions, and reasonable and supportable forecasts. Financial institutions and other organizations will use forward-looking information to better inform their credit loss estimates. Many of the loss estimation techniques applied today will still be permitted, although the inputs to those techniques will change to



reflect the full amount of expected credit losses. Organizations will continue to use judgment to determine which loss estimation method is appropriate for their circumstances. Additionally, the ASU amends the accounting for credit losses on available-for-sale debt securities and purchased financial assets with credit deterioration. This update will be effective for the Company's reporting period beginning January 1, 2020. We are currently evaluating the potential impact the update will have on our consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." ASU 2016-15 provides guidance on eight statement of cash flow classification issues and is intended to reduce the current and future diversity in practice described in the amendments. Current GAAP is either unclear or does not include specific guidance on the eight statement of cash flow classification issues included in ASU 2016-15. ASU 2016-15 is effective for the Company's reporting period beginning January 1, 2018. Early adoption is permitted, provided that all of the amendments are adopted in the same period. We do not plan to early adopt ASU 2016-15. The amendments in ASU 2016-15 should be applied using a retrospective transition method to each period presented. If it is impracticable to apply the amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. Among other things, the update clarifies the appropriate classification for proceeds from settlement of bank owned life insurance ("BOLI") policies. Based on preliminary evaluation, our current practice is consistent with the update and we thus do not expect the update to have a reclassification impact. Additionally, we do not expect other changes in classification resulting from this update to be significant.

### 3. INVESTMENT SECURITIES

A summary of held-to-maturity and available-for-sale investment securities are as follows:

| (dollars in thousands)  | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|---|-------------------|------------------------------|-------------------------------|---------------|
| June 30, 2017   |                   |                              |                               |               |
| Held-to-Maturity:   |                   |                              |                               |               |
| Mortgage-backed securities:   |                   |                              |                               |               |
| Residential - U.S. Government-sponsored entities                            | \$112,053         | \$ 110                       | \$ (1,839 )                   | \$110,324     |
| Commercial - U.S. Government-sponsored entities                             | 92,535            | 475                          | —                             | 93,010        |
| Total   | \$204,588         | \$ 585                       | \$ (1,839 )                   | \$203,334     |
| Available-for-Sale:   |                   |                              |                               |               |
| Debt securities:  |                   |                              |                               |               |
| States and political subdivisions   | \$182,853         | \$ 3,350                     | \$ (521 )                     | \$185,682     |
| Corporate securities  | 92,827            | 1,325                        | (80 )                         | 94,072        |
| U.S. Treasury obligations and direct obligations of U.S Government agencies | 26,395            | 114                          | (3 )                          | 26,506        |
| Mortgage-backed securities:   |                   |                              |                               |               |
| Residential - U.S. Government-sponsored entities                            | 791,720           | 3,526                        | (6,908 )                      | 788,338       |
| Commercial - U.S. Government agencies and sponsored entities                | 32,659            | 73                           | (184 )                        | 32,548        |
| Residential - Non-government agencies                                       | 48,420            | 773                          | (239 )                        | 48,954        |
| Commercial - Non-government agencies  | 135,153           | 3,945                        | (112 )                        | 138,986       |
| Other   | 694               | 115                          | —                             | 809           |
| Total   | \$1,310,721       | \$ 13,221                    | \$ (8,047 )                   | \$1,315,895   |



| (dollars in thousands)                           | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|--|-------------------|------------------------------|-------------------------------|---------------|
| December 31, 2016                                |                   |                              |                               |               |
| Held-to-Maturity:                                |                   |                              |                               |               |
| Mortgage-backed securities:                      |                   |                              |                               |               |
| Residential - U.S. Government-sponsored entities | \$ 124,082        | \$ 92                        | \$ (2,474 )                   | \$ 121,700    |
| Commercial - U.S. Government-sponsored entities  | 93,586            | —                            | (920 )                        | 92,666        |
| Total  | \$ 217,668        | \$ 92                        | \$ (3,394 )                   | \$ 214,366    |
| Available-for-Sale:                              |                   |                              |                               |               |
| Debt securities:                                 |                   |                              |                               |               |
| States and political subdivisions                | \$ 184,836        | \$ 2,002                     | \$ (1,797 )                   | \$ 185,041    |
| Corporate securities                             | 98,596            | 974                          | (181 )                        | 99,389        |
| Mortgage-backed securities:                      |                   |                              |                               |               |
| Residential - U.S. Government-sponsored entities | 775,803           | 3,698                        | (9,515 )                      | 769,986       |
| Residential - Non-government agencies            | 51,681            | 627                          | (761 )                        | 51,547        |
| Commercial - Non-government agencies             | 135,248           | 2,387                        | (411 )                        | 137,224       |
| Other  | 564               | 96                           | —                             | 660           |
| Total  | \$ 1,246,728      | \$ 9,784                     | \$ (12,665 )                  | \$ 1,243,847  |

The amortized cost and estimated fair value of investment securities at June 30, 2017 by contractual maturity are shown below. Expected maturities will differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

| (dollars in thousands)                                       | June 30, 2017     |              |
|--|-------------------|--------------|
|  | Amortized<br>Cost | Fair Value   |
| Held-to-Maturity:  |                   |              |
| Mortgage-backed securities:                                  |                   |              |
| Residential - U.S. Government-sponsored entities             | \$ 112,053        | \$ 110,324   |
| Commercial - U.S. Government-sponsored entities              | 92,535            | 93,010       |
| Total  | \$ 204,588        | \$ 203,334   |
| Available-for-Sale:  |                   |              |
| Due in one year or less                                      | \$ 8,807          | \$ 8,866     |
| Due after one year through five years                        | 144,860           | 146,731      |
| Due after five years through ten years                       | 53,401            | 54,410       |
| Due after ten years  | 95,007            | 96,253       |
| Mortgage-backed securities:                                  |                   |              |
| Residential - U.S. Government-sponsored entities             | 791,720           | 788,338      |
| Commercial - U.S. Government agencies and sponsored entities | 32,659            | 32,548       |
| Residential - Non-government agencies                        | 48,420            | 48,954       |
| Commercial - Non-government agencies                         | 135,153           | 138,986      |
| Other  | 694               | 809          |
| Total  | \$ 1,310,721      | \$ 1,315,895 |

In the second quarter of 2017, we completed an investment portfolio repositioning strategy designed to enhance potential prospective earnings and improve net interest margin. In connection with the repositioning, we sold \$97.7 million in lower-yielding available-for-sale securities, and purchased \$97.4 million in higher yielding, longer duration investment securities. The

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investment securities sold had a duration of 3.3 and an average yield of 1.91%. Gross proceeds of the sale of \$96.0 million were immediately reinvested back into investment securities with a duration of 4.6 and an average yield of 2.57%. The new securities were classified in the available-for-sale portfolio. There were no gross realized gains on the sale of the investment securities. Gross realized losses on the sale of the investment securities were \$1.6 million. The specific identification method was used as the basis for determining the cost of all securities sold. We did not sell any available-for-sale securities during the three months ended March 31, 2017. We also did not sell any available-for-sale securities during the six months ended June 30, 2016.

Investment securities of \$1.02 billion and \$1.05 billion at June 30, 2017 and December 31, 2016, respectively, were pledged to secure public funds on deposit and other long-term debt and short-term borrowings.

Provided below is a summary of the 138 and 242 investment securities which were in an unrealized loss position at June 30, 2017 and December 31, 2016, respectively, segregated by continuous length of impairment.

| (dollars in thousands)  | Less Than<br>Fair<br>Value | 12 Months<br>Unrealized<br>Losses | 12 Months or Longer<br>Fair<br>Value | 12 Months or Longer<br>Unrealized<br>Losses | Total<br>Fair<br>Value | Unrealized<br>Losses |
|---|----------------------------|-----------------------------------|--------------------------------------|---|------------------------|----------------------|
| June 30, 2017   |                            |                                   |                                      |   |                        |                      |
| Debt securities:  |                            |                                   |                                      |   |                        |                      |
| States and political subdivisions   | \$ 38,303                  | \$ (497 )                         | \$ 1,126                             | \$ (24 )                                    | \$ 39,429              | \$ (521 )            |
| Corporate securities  | —                          | —                                 | 5,353                                | (80 )                                       | 5,353                  | (80 )                |
| U.S. Treasury obligations and direct obligations of U.S Government agencies | 3,380                      | (3 )                              | —                                    | —   | 3,380                  | (3 )                 |
| Mortgage-backed securities:   |                            |                                   |                                      |   |                        |                      |
| Residential - U.S. Government-sponsored entities                            | 547,203                    | (8,383 )                          | 10,747                               | (364 )                                      | 557,950                | (8,747 )             |
| Residential - Non-government agencies                                       | 10,506                     | (239 )                            | —                                    | —   | 10,506                 | (239 )               |
| Commercial - U.S. Government agencies and sponsored entities                | 11,548                     | (184 )                            | —                                    | —   | 11,548                 | (184 )               |
| Commercial - Non-government agencies  | 9,498                      | (112 )                            | —                                    | —   | 9,498                  | (112 )               |
| Total temporarily impaired securities                                       | \$ 620,438                 | \$ (9,418 )                       | \$ 17,226                            | \$ (468 )                                   | \$ 637,664             | \$ (9,886 )          |

| (dollars in thousands)                           | Less Than<br>Fair<br>Value | 12 Months<br>Unrealized<br>Losses | 12 Months or Longer<br>Fair<br>Value | 12 Months or Longer<br>Unrealized<br>Losses | Total<br>Fair<br>Value | Unrealized<br>Losses |
|--|----------------------------|-----------------------------------|--------------------------------------|---|------------------------|----------------------|
| December 31, 2016                                |                            |                                   |                                      |   |                        |                      |
| Debt securities:                                 |                            |                                   |                                      |   |                        |                      |
| States and political subdivisions                | \$ 85,288                  | \$ (1,797 )                       | \$ —                                 | \$ —  | \$ 85,288              | \$ (1,797 )          |
| Corporate securities                             | 20,357                     | (181 )                            | —                                    | —   | 20,357                 | (181 )               |
| Mortgage-backed securities:                      |                            |                                   |                                      |   |                        |                      |
| Residential - U.S. Government-sponsored entities | 648,923                    | (11,766 )                         | 3,978                                | (223 )                                      | 652,901                | (11,989 )            |
| Residential - Non-government agencies            | 30,596                     | (761 )                            | —                                    | —   | 30,596                 | (761 )               |
| Commercial - U.S. Government-sponsored entities  | 92,666                     | (920 )                            | —                                    | —   | 92,666                 | (920 )               |
| Commercial - Non-government agencies             | 52,880                     | (411 )                            | —                                    | —   | 52,880                 | (411 )               |
| Total temporarily impaired securities            | \$ 930,710                 | \$ (15,836 )                      | \$ 3,978                             | \$ (223 )                                   | \$ 934,688             | \$ (16,059 )         |

Other-Than-Temporary Impairment ("OTTI")

Unrealized losses for all investment securities are reviewed to determine whether the losses are deemed "other-than-temporary." Investment securities are evaluated for OTTI on at least a quarterly basis and more frequently when economic or market conditions warrant such an evaluation to determine whether a decline in their value below amortized cost is other-than-temporary. In conducting this assessment, we evaluate a number of factors including, but not limited to:

• The length of time and the extent to which fair value has been less than the amortized cost basis;

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- Adverse conditions specifically related to the security, an industry, or a geographic area;
  - The historical and implied volatility of the fair value of the security;
- The payment structure of the debt security and the likelihood of the issuer being able to make payments;
- Failure of the issuer to make scheduled interest or principal payments;
- Any rating changes by a rating agency; and
- Recoveries or additional declines in fair value subsequent to the balance sheet date.

The term "other-than-temporary" is not intended to indicate that the decline is permanent, but indicates that the prospects for a near-term recovery of value are not necessarily favorable, or that there is a general lack of evidence to support a realizable value equal to or greater than the carrying value of the investment. Once a decline in value is determined to be other-than-temporary, the value of the security is reduced and a corresponding charge to earnings is recognized for anticipated credit losses.

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

#### 4. LOANS AND LEASES

Loans and leases, excluding loans held for sale, consisted of the following:

| (dollars in thousands)                        | June 30,<br>2017 | December 31,<br>2016 |
|---|------------------|----------------------|
| Commercial, financial and agricultural        | \$499,693        | \$ 509,987           |
| Real estate:                                  |                  |                      |
| Construction                                  | 94,324           | 101,729              |
| Residential mortgage                          | 1,246,159        | 1,213,983            |
| Home equity                                   | 394,721          | 361,210              |
| Commercial mortgage                           | 896,221          | 886,615              |
| Consumer:                                     |                  |                      |
| Automobiles                                   | 256,858          | 212,926              |
| Other consumer                                | 201,392          | 235,684              |
| Leases  | 523              | 677                  |
| Gross loans and leases                        | 3,589,891        | 3,522,811            |
| Net deferred costs                            | 1,844            | 2,079                |
| Total loans and leases, net of deferred costs | \$3,591,735      | \$ 3,524,890         |

During the six months ended June 30, 2017, we foreclosed on one loan totaling \$0.1 million. We did not transfer any loans to the held-for-sale category. In addition, we did not sell any portfolio loans during the six months ended June 30, 2017.

During the six months ended June 30, 2016, we foreclosed on one portfolio loan totaling \$0.5 million. We did not transfer any loans to the held-for-sale category. In addition, we did not sell any portfolio loans during the six months ended June 30, 2016.

In May 2017, we purchased an indirect auto loan portfolio totaling \$26.6 million which included a \$0.9 million premium over the \$25.7 million outstanding balance. At the time of purchase, the auto loans had a weighted average

remaining term of 77 months and a weighted average yield, net of the premium paid and servicing costs, of 2.67%.

In March 2017, we purchased a direct auto loan portfolio totaling \$24.1 million which included a \$0.4 million premium over the \$23.8 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 55 months and a weighted average yield, net of the premium paid and servicing costs, of 2.60%.

In May 2016, we purchased an indirect auto loan portfolio totaling \$18.0 million which included a \$0.5 million premium over the \$17.5 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 75 months and a weighted average yield, net of the premium paid and servicing costs, of 2.50%. During the second quarter of 2016, we also purchased unsecured consumer loans totaling \$6.9 million, which represented the outstanding balance at the time



of purchases. At the time of purchases, the unsecured consumer loans had a weighted average remaining term of 37 months and a weighted average yield net of servicing costs of 5.57%.

In March 2016, we purchased a direct auto loan portfolio totaling \$23.2 million which included a \$0.3 million premium over the \$22.9 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 56 months and a weighted average yield, net of the premium paid and servicing costs, of 2.63%. During the first quarter of 2016, we also purchased unsecured consumer loans totaling \$28.8 million, which represented the outstanding balance at the time of purchases. At the time of purchases, the unsecured consumer loans had a weighted average remaining term of 38 months and a weighted average yield net of servicing costs of 5.55%.

### Impaired Loans

The following tables present by class, the balance in the allowance for loan and lease losses (the "Allowance") and the recorded investment in loans and leases based on the Company's impairment measurement method as of June 30, 2017 and December 31, 2016:

| (dollars in thousands)                                 | Comml, Fin & Ag | Real Estate |               |             | Comml Mortgage | Consumer - Auto | Consumer - Other | Leases | Total       |
|--|-----------------|-------------|---------------|-------------|----------------|-----------------|------------------|--------|-------------|
|  |                 | Constr      | Resi Mortgage | Home Equity |                |                 |                  |        |             |
| June 30, 2017  |                 |             |               |             |                |                 |                  |        |             |
| Allowance:   |                 |             |               |             |                |                 |                  |        |             |
| Individually evaluated for impairment                  | \$—             | \$—         | \$—           | \$—         | \$—            | \$—             | \$—              | \$—    | \$—         |
| Collectively evaluated for impairment                  | 8,598           | 3,212       | 14,034        | 3,370       | 18,184         | 2,780           | 2,650            | —      | 52,828      |
| Total ending balance                                   | \$8,598         | \$3,212     | \$14,034      | \$3,370     | \$18,184       | \$2,780         | \$2,650          | \$—    | \$52,828    |
| Loans and leases:                                      |                 |             |               |             |                |                 |                  |        |             |
| Individually evaluated for impairment                  | \$1,265         | \$2,757     | \$17,225      | \$1,509     | \$5,302        | \$—             | \$—              | \$—    | \$28,058    |
| Collectively evaluated for impairment                  | 498,428         | 91,567      | 1,228,934     | 393,212     | 890,919        | 256,858         | 201,392          | 523    | 3,561,833   |
| Subtotal   | 499,693         | 94,324      | 1,246,159     | 394,721     | 896,221        | 256,858         | 201,392          | 523    | 3,589,891   |
| Net deferred costs (income)                            | 199             | (487)       | 3,458         | (1)         | (1,209)        | —               | (116)            | —      | 1,844       |
| Total loans and leases, net of deferred costs (income) | \$499,892       | \$93,837    | \$1,249,617   | \$394,720   | \$895,012      | \$256,858       | \$201,276        | \$523  | \$3,591,735 |

| (dollars in thousands) | Comml, Fin & Ag | Real Estate |               |             | Comml Mortgage | Consumer - Auto | Consumer - Other | Leases | Total |
|------------------------|-----------------|-------------|---------------|-------------|----------------|-----------------|------------------|--------|-------|
|                        |                 | Constr      | Resi Mortgage | Home Equity |                |                 |                  |        |       |
| December 31, 2016      |                 |             |               |             |                |                 |                  |        |       |

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Allowance:

|                                       |         |         |          |         |          |         |       |     |          |
|---------------------------------------|---------|---------|----------|---------|----------|---------|-------|-----|----------|
| Individually evaluated for impairment | \$—     | \$—     | \$—      | \$—     | \$—      | \$—     | \$—   | \$— | \$—      |
| Collectively evaluated for impairment | 8,637   | 4,224   | 15,055   | 3,502   | 19,104   | 3,000   | 3,109 | —   | 56,631   |
| Total ending balance                  | \$8,637 | \$4,224 | \$15,055 | \$3,502 | \$19,104 | \$3,000 | 3,109 | \$— | \$56,631 |

Loans and leases:

|  |           |           |             |           |           |           |             |     |             |
|--|-----------|-----------|-------------|-----------|-----------|-----------|-------------|-----|-------------|
| Individually evaluated for impairment                  | \$1,877   | \$2,936   | \$19,940    | \$333     | \$5,637   | \$—       | \$—         | \$— | \$30,723    |
| Collectively evaluated for impairment                  | 508,110   | 98,793    | 1,194,043   | 360,877   | 880,978   | 212,926   | 235,684,677 |     | 3,492,088   |
| Subtotal   | 509,987   | 101,729   | 1,213,983   | 361,210   | 886,615   | 212,926   | 235,684,677 |     | 3,522,811   |
| Net deferred costs (income)                            | 453       | (191)     | 3,251       | (1)       | (1,176)   | —         | (257)       | —   | 2,079       |
| Total loans and leases, net of deferred costs (income) | \$510,440 | \$101,538 | \$1,217,234 | \$361,209 | \$885,439 | \$212,926 | 235,427,677 |     | \$3,524,890 |

There were no impaired loans with an allowance recorded as of June 30, 2017 and December 31, 2016. The following table presents by class, information related to impaired loans as of June 30, 2017 and December 31, 2016:

|  | June 30, 2017            |                     |                     | December 31, 2016        |                     |                     |
|--|--------------------------|---------------------|---------------------|--------------------------|---------------------|---------------------|
|  | Unpaid Principal Balance | Recorded Investment | Allowance Allocated | Unpaid Principal Balance | Recorded Investment | Allowance Allocated |
| (dollars in thousands)                             |                          |                     |                     |                          |                     |                     |
| Impaired loans with no related Allowance recorded: |                          |                     |                     |                          |                     |                     |
| Commercial, financial & agricultural               | \$1,376                  | \$ 1,265            | \$ —                | —\$1,988                 | \$ 1,877            | \$ —                |
| Real estate:                                       |                          |                     |                     |                          |                     |                     |
| Construction                                       | 8,107                    | 2,757               | —                   | 9,056                    | 2,936               | —                   |
| Residential mortgage                               | 18,284                   | 17,225              | —                   | 21,568                   | 19,940              | —                   |
| Home equity  | 1,509                    | 1,509               | —                   | 333                      | 333                 | —                   |
| Commercial mortgage                                | 5,302                    | 5,302               | —                   | 5,637                    | 5,637               | —                   |
| Total impaired loans                               | \$34,578                 | \$ 28,058           | \$ —                | —\$38,582                | \$ 30,723           | \$ —                |

The following table presents by class, the average recorded investment and interest income recognized on impaired loans for the three and six months ended June 30, 2017 and 2016:

|                                      | Three Months Ended          |                                    |                             |                                    | Six Months Ended            |                                    |                             |                                    |
|--------------------------------------|-----------------------------|------------------------------------|-----------------------------|------------------------------------|-----------------------------|------------------------------------|-----------------------------|------------------------------------|
|                                      | June 30, 2017               |                                    | June 30, 2016               |                                    | June 30, 2017               |                                    | June 30, 2016               |                                    |
| (dollars in thousands)               | Average Recorded Investment | Average Interest Income Recognized | Average Recorded Investment | Average Interest Income Recognized | Average Recorded Investment | Average Interest Income Recognized | Average Recorded Investment | Average Interest Income Recognized |
| Commercial, financial & agricultural | \$1,291                     | \$ 4                               | \$2,176                     | \$ 10                              | \$1,624                     | \$ 4                               | \$1,799                     | \$ 10                              |
| Real estate:                         |                             |                                    |                             |                                    |                             |                                    |                             |                                    |
| Construction                         | 2,783                       | 24                                 | 3,917                       | 34                                 | 2,841                       | 48                                 | 3,982                       | 70                                 |
| Residential mortgage                 | 17,658                      | 1,070                              | 22,718                      | 9                                  | 18,597                      | 1,167                              | 22,235                      | 7                                  |
| Home equity                          | 1,482                       | 1                                  | 723                         | —                                  | 1,310                       | 1                                  | 639                         | —                                  |
| Commercial mortgage                  | 5,346                       | 46                                 | 8,786                       | 37                                 | 5,445                       | 93                                 | 9,463                       | 71                                 |
| Total                                | \$28,560                    | \$ 1,145                           | \$38,320                    | \$ 90                              | \$29,817                    | \$ 1,313                           | \$38,118                    | \$ 158                             |

#### Foreclosure Proceedings

The Company had \$1.3 million and \$0.3 million of residential mortgage loans collateralized by residential real estate property that were in the process of foreclosure at June 30, 2017 and December 31, 2016, respectively.

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

For all loan types, the Company determines delinquency status by considering the number of days full payments required by the contractual terms of the loan are past due. The following tables present by class, the aging of the recorded investment in past due loans and leases as of June 30, 2017 and December 31, 2016:

| (dollars in thousands)               | Accruing<br>Loans<br>30 - 59<br>Days<br>Past Due | Accruing<br>Loans<br>60 - 89<br>Days<br>Past Due | Accruing<br>Loans<br>Greater Than<br>90 Days<br>Past Due | Nonaccrual<br>Loans | Total<br>Past Due<br>and<br>Nonaccrual | Loans and<br>Leases<br>Not<br>Past Due | Total       |
|--------------------------------------|--|--|--|---------------------|--|--|-------------|
| June 30, 2017                        |  |  |  |                     |  |  |             |
| Commercial, financial & agricultural | \$ 225   | \$ 53  | \$ —   | \$ 1,000            | \$ 1,278                               | \$498,614                              | \$499,892   |
| Real estate:                         |  |  |  |                     |  |  |             |
| Construction                         | —  | —  | —  | —                   | —                                      | 93,837                                 | 93,837      |
| Residential mortgage                 | —  | 1,887  | —  | 4,691               | 6,578                                  | 1,243,039                              | 1,249,617   |
| Home equity                          | 216  | 183  | —  | 1,509               | 1,908                                  | 392,812                                | 394,720     |
| Commercial mortgage                  | 83   | —  | —  | 834                 | 917                                    | 894,095                                | 895,012     |
| Consumer:                            |  |  |  |                     |  |  |             |
| Automobiles                          | 972  | 244  | 130  | —                   | 1,346                                  | 255,512                                | 256,858     |
| Other consumer                       | 708  | 368  | 123  | —                   | 1,199                                  | 200,077                                | 201,276     |
| Leases                               | —  | —  | —  | —                   | —                                      | 523                                    | 523         |
| Total                                | \$ 2,204   | \$ 2,735   | \$ 253   | \$ 8,034            | \$ 13,226                              | \$3,578,509                            | \$3,591,735 |

| (dollars in thousands)               | Accruing<br>Loans<br>30 - 59<br>Days<br>Past Due | Accruing<br>Loans<br>60 - 89<br>Days<br>Past Due | Accruing<br>Loans<br>Greater Than<br>90 Days<br>Past Due | Nonaccrual<br>Loans | Total<br>Past Due<br>and<br>Nonaccrual | Loans and<br>Leases<br>Not<br>Past Due | Total       |
|--------------------------------------|--|--|--|---------------------|--|--|-------------|
| December 31, 2016                    |  |  |  |                     |  |  |             |
| Commercial, financial & agricultural | \$ 761   | \$ 80  | \$ —   | \$ 1,877            | \$ 2,718                               | \$507,722                              | \$510,440   |
| Real estate:                         |  |  |  |                     |  |  |             |
| Construction                         | —  | —  | —  | —                   | —                                      | 101,538                                | 101,538     |
| Residential mortgage                 | 5,014  | 478  | —  | 5,322               | 10,814                                 | 1,206,420                              | 1,217,234   |
| Home equity                          | 43   | 280  | 1,120  | 333                 | 1,776                                  | 359,433                                | 361,209     |
| Commercial mortgage                  | 127  | —  | —  | 864                 | 991                                    | 884,448                                | 885,439     |
| Consumer:                            |  |  |  |                     |  |  |             |
| Automobiles                          | 743  | 353  | 208  | —                   | 1,304                                  | 211,622                                | 212,926     |
| Other consumer                       | 639  | 272  | 63   | —                   | 974                                    | 234,453                                | 235,427     |
| Leases                               | —  | —  | —  | —                   | —                                      | 677                                    | 677         |
| Total                                | \$ 7,327   | \$ 1,463   | \$ 1,391   | \$ 8,396            | \$ 18,577                              | \$3,506,313                            | \$3,524,890 |

## Modifications

Troubled debt restructurings ("TDRs") included in nonperforming assets at June 30, 2017 totaled \$3.8 million and consisted of 12 Hawaii residential mortgage loans with a combined principal balance of \$2.8 million and two Hawaii commercial, financial and agricultural loans with a combined principal balance of \$1.0 million.

Concessions made to the original contractual terms of these loans consisted primarily of the deferral of interest and/or principal payments due to deterioration in the borrowers' financial condition. The principal balances on these TDRs had matured and/or were in default at the time of restructure and we have no commitments to lend additional funds to any of these borrowers. There were \$14.2 million of TDRs still accruing interest at June 30, 2017, none of which were more than 90 days delinquent. At December 31, 2016, there were \$20.3 million of TDRs still accruing interest, none of which were more than 90 days delinquent.

Some loans modified in a TDR may already be on nonaccrual status and partial charge-offs may have already been taken against the outstanding loan balance. Thus, these loans have already been identified as impaired and have already been

evaluated under the Company's allowance for loan and lease losses (the "Allowance") methodology. Loans that were not on nonaccrual status when modified in a TDR may have the financial effect of increasing the specific allowance associated with the loan. The loans modified in a TDR did not have a material effect on our provision for loan and lease losses (the "Provision") and the Allowance during the three and six months ended June 30, 2017.

The following table presents by class, information related to loans modified in a TDR during the period presented. No loans were modified in a TDR during the three months ended June 30, 2017 or the three and six months ended June 30, 2016.

| (dollars in thousands)                 | Number<br>of<br>Contracts | Recorded<br>Investment<br>(as of Period End) | Increase<br>in the<br>Allowance |
|--|---------------------------|--|---------------------------------|
| Six Months Ended June 30, 2017         |                           |  |                                 |
| Commercial, financial & agricultural 1 | 653                       |  | —                               |

No loans were modified as a TDR within the previous twelve months that subsequently defaulted during the three and six months ended June 30, 2017 and 2016.

#### Credit Quality Indicators

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

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

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

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

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



Loans and leases not meeting the criteria above are considered to be pass-rated. The following table presents by class and credit indicator, the recorded investment in the Company's loans and leases as of June 30, 2017 and December 31, 2016:

| (dollars in thousands)               | Pass        | Special<br>Mention | Substandard | Loss   | Subtotal    | Net<br>Deferred<br>Costs<br>(Income) | Total       |
|--------------------------------------|-------------|--------------------|-------------|--------|-------------|--------------------------------------|-------------|
| June 30, 2017                        |             |                    |             |        |             |                                      |             |
| Commercial, financial & agricultural | \$475,393   | \$2,106            | \$ 22,194   | \$ —   | \$499,693   | \$ 199                               | \$499,892   |
| Real estate:                         |             |                    |             |        |             |                                      |             |
| Construction                         | 83,720      | 10,604             | —           | —      | 94,324      | (487 )                               | 93,837      |
| Residential mortgage                 | 1,241,362   | —                  | 4,797       | —      | 1,246,159   | 3,458                                | 1,249,617   |
| Home equity                          | 393,212     | —                  | 1,509       | —      | 394,721     | (1 )                                 | 394,720     |
| Commercial mortgage                  | 861,699     | 22,622             | 11,900      | —      | 896,221     | (1,209 )                             | 895,012     |
| Consumer:                            |             |                    |             |        |             |                                      |             |
| Automobiles                          | 256,728     | —                  | 66          | 64     | 256,858     | —                                    | 256,858     |
| Other consumer                       | 201,202     | —                  | 190         | —      | 201,392     | (116 )                               | 201,276     |
| Leases                               | 523         | —                  | —           | —      | 523         | —                                    | 523         |
| Total                                | \$3,513,839 | \$35,332           | \$ 40,656   | \$ 64  | \$3,589,891 | \$ 1,844                             | \$3,591,735 |
| December 31, 2016                    |             |                    |             |        |             |                                      |             |
| Commercial, financial & agricultural | \$502,305   | \$2,632            | \$ 5,050    | \$ —   | \$509,987   | \$ 453                               | \$510,440   |
| Real estate:                         |             |                    |             |        |             |                                      |             |
| Construction                         | 91,812      | 9,896              | 21          | —      | 101,729     | (191 )                               | 101,538     |
| Residential mortgage                 | 1,208,552   | 109                | 5,322       | —      | 1,213,983   | 3,251                                | 1,217,234   |
| Home equity                          | 359,757     | —                  | 1,453       | —      | 361,210     | (1 )                                 | 361,209     |
| Commercial mortgage                  | 852,872     | 18,845             | 14,898      | —      | 886,615     | (1,176 )                             | 885,439     |
| Consumer:                            |             |                    |             |        |             |                                      |             |
| Automobiles                          | 212,718     | —                  | 50          | 158    | 212,926     | —                                    | 212,926     |
| Other consumer                       | 235,544     | —                  | 140         | —      | 235,684     | (257 )                               | 235,427     |
| Leases                               | 677         | —                  | —           | —      | 677         | —                                    | 677         |
| Total                                | \$3,464,237 | \$31,482           | \$ 26,934   | \$ 158 | \$3,522,811 | \$ 2,079                             | \$3,524,890 |

In accordance with applicable Interagency Guidance issued by our primary bank regulators, we define subprime borrowers as typically having weakened credit histories that include payment delinquencies and possibly more severe problems such as charge-offs, judgments, and bankruptcies. They may also display reduced repayment capacity as measured by credit scores, debt-to-income ratios, or other criteria that may encompass borrowers with incomplete credit histories. Subprime loans are loans to borrowers displaying one or more of these characteristics at the time of origination or purchase. Such loans have a higher risk of default than loans to prime borrowers. At June 30, 2017 and December 31, 2016, we did not have any loans that we considered to be subprime.



## 5. ALLOWANCE FOR LOAN AND LEASE LOSSES

The following table presents by class, the activity in the Allowance for the periods indicated:

|   | Real Estate                                |                          |                         |                |                        |                    |                     |        |             |          |
|---|--|--------------------------|-------------------------|----------------|------------------------|--------------------|---------------------|--------|-------------|----------|
|   | Commercial,<br>Financial &<br>Agricultural | Construction<br>Mortgage | Residential<br>Mortgage | Home<br>Equity | Commercial<br>Mortgage | Consumer<br>- Auto | Consumer<br>- Other | Leases | Unallocated | Total    |
|   | (dollars in thousands)                     |                          |                         |                |                        |                    |                     |        |             |          |
| Three Months Ended June 30, 2017                |  |                          |                         |                |                        |                    |                     |        |             |          |
| Beginning balance                               | \$8,346                                    | \$3,718                  | \$14,892                | \$3,425        | \$19,187               | \$2,976            | \$2,825             | \$—    | \$—         | \$55,369 |
| Provision (credit) for<br>loan and lease losses | 353  | (562)                    | (1,495)                 | (82)           | (1,131)                | (128)              | 763                 | —      | —           | (2,282)  |
| Charge-offs                                     | 8,699                                      | 3,156                    | 13,397                  | 3,343          | 18,056                 | 2,848              | 3,588               | —      | —           | 53,087   |
| Recoveries                                      | 337  | —                        | —                       | —              | —                      | 352                | 1,118               | —      | —           | 1,807    |
| Net charge-offs<br>(recoveries)                 | 236  | 56                       | 637                     | 27             | 128                    | 284                | 180                 | —      | —           | 1,548    |
| Ending balance                                  | 101  | (56)                     | (637)                   | (27)           | (128)                  | 68                 | 938                 | —      | —           | 259      |
| Ending balance                                  | \$8,598                                    | \$3,212                  | \$14,034                | \$3,370        | \$18,184               | \$2,780            | \$2,650             | \$—    | \$—         | \$52,828 |
| Three Months Ended June 30, 2016                |  |                          |                         |                |                        |                    |                     |        |             |          |
| Beginning balance                               | \$7,000                                    | \$4,128                  | \$14,696                | \$3,309        | \$25,173               | \$2,723            | \$3,120             | \$—    | \$2,000     | \$62,149 |
| Provision (credit) for<br>loan and lease losses | (3,006)                                    | (314)                    | (677)                   | 133            | 2,261                  | (158)              | 379                 | —      | —           | (1,382)  |
| Charge-offs                                     | 3,994                                      | 3,814                    | 14,019                  | 3,442          | 27,434                 | 2,565              | 3,499               | —      | 2,000       | 60,767   |
| Recoveries                                      | 272  | —                        | —                       | —              | —                      | 358                | 777                 | —      | —           | 1,407    |
| Net charge-offs<br>(recoveries)                 | 720  | 9                        | 173                     | 4              | 14                     | 366                | 118                 | —      | —           | 1,404    |
| Ending balance                                  | (448)                                      | (9)                      | (173)                   | (4)            | (14)                   | (8)                | 659                 | —      | —           | 3        |
| Ending balance                                  | \$4,442                                    | \$3,823                  | \$14,192                | \$3,446        | \$27,448               | \$2,573            | \$2,840             | \$—    | \$2,000     | \$60,764 |
| Six Months Ended June 30, 2017                  |  |                          |                         |                |                        |                    |                     |        |             |          |
| Beginning balance                               | \$8,637                                    | \$4,224                  | \$15,055                | \$3,502        | \$19,104               | \$3,000            | \$3,109             | \$—    | \$—         | \$56,631 |
| Provision (credit) for<br>loan and lease losses | 287  | (1,089)                  | (1,754)                 | (161)          | (1,059)                | 174                | 1,240               | —      | —           | (2,362)  |
| Charge-offs                                     | 8,924                                      | 3,135                    | 13,301                  | 3,341          | 18,045                 | 3,174              | 4,349               | —      | —           | 54,269   |
| Recoveries                                      | 837  | —                        | —                       | —              | —                      | 872                | 2,095               | —      | —           | 3,804    |
| Net charge-offs<br>(recoveries)                 | 511  | 77                       | 733                     | 29             | 139                    | 478                | 396                 | —      | —           | 2,363    |
| Ending balance                                  | 326  | (77)                     | (733)                   | (29)           | (139)                  | 394                | 1,699               | —      | —           | 1,441    |
| Ending balance                                  | \$8,598                                    | \$3,212                  | \$14,034                | \$3,370        | \$18,184               | \$2,780            | \$2,650             | \$—    | \$—         | \$52,828 |
| Six Months Ended June 30, 2016                  |  |                          |                         |                |                        |                    |                     |        |             |          |
| Beginning balance                               | \$6,905                                    | \$8,454                  | \$14,642                | \$3,096        | \$21,847               | \$2,891            | \$3,339             | \$—    | \$2,140     | \$63,314 |

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|  |          |          |          |         |          |         |         |    |          |          |
|--|----------|----------|----------|---------|----------|---------|---------|----|----------|----------|
| Provision (credit) for loan and lease losses | (2,908 ) | (4,649 ) | (656 )   | 342     | 5,574    | (139 )  | 447     | —  | (140 )   | (2,129 ) |
|  | 3,997    | 3,805    | 13,986   | 3,438   | 27,421   | 2,752   | 3,786   | —  | 2,000    | 61,185   |
| Charge-offs                                  | 624      | —        | —        | —       | —        | 738     | 1,509   | —  | —        | 2,871    |
| Recoveries                                   | 1,069    | 18       | 206      | 8       | 27       | 559     | 563     | —  | —        | 2,450    |
| Net charge-offs (recoveries)                 | (445 )   | (18 )    | (206 )   | (8 )    | (27 )    | 179     | 946     | —  | —        | 421      |
| Ending balance                               | \$4,442  | \$3,823  | \$14,192 | \$3,446 | \$27,448 | \$2,573 | \$2,840 | \$ | —\$2,000 | \$60,764 |

Loans held for sale and other real estate assets are not included in our assessment of the Allowance.

Our Provision was a credit of \$2.3 million and \$2.4 million in the three and six months ended June 30, 2017, compared to a credit of \$1.4 million and \$2.1 million in the three and six months ended June 30, 2016.

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

## 6. SECURITIZATIONS

In prior years, we securitized certain residential mortgage loans with a U.S. Government sponsored entity and continue to service the residential mortgage loans. The servicing assets were recorded at their respective fair values at the time of securitization.

All unsold mortgage-backed securities from prior securitizations were categorized as available for sale securities and were therefore recorded at their fair values of \$1.5 million and \$2.0 million at June 30, 2017 and December 31, 2016, respectively. The fair values of these mortgage-backed securities were based on quoted prices of similar instruments in active markets. Unrealized gains of \$0.1 million and \$0.1 million on unsold mortgage-backed securities were recorded in accumulated other comprehensive income ("AOCI") at June 30, 2017 and December 31, 2016, respectively.

## 7. INVESTMENTS IN UNCONSOLIDATED SUBSIDIARIES

The components of the Company's investments in unconsolidated subsidiaries were as follows:

| (dollars in thousands)                                    | June<br>30,<br>2017 | December<br>31, 2016 |
|---|---------------------|----------------------|
| Investments in low income housing tax credit partnerships | \$2,896             | \$ 3,353             |
| Trust preferred investments                               | 2,792               | 2,792                |
| Investments in affiliates                                 | 447                 | 690                  |
| Other   | 54                  | 54                   |
| Total   | \$6,189             | \$ 6,889             |

The Company had \$1.7 million in unfunded low income housing commitments as of June 30, 2017 and December 31, 2016, of which \$1.0 million is expected to be paid in 2018 and \$0.7 million is expected to be paid in 2019.

Investments in low income housing tax credit ("LIHTC") partnerships are accounted for using the cost method. The following table presents amortization and tax credits recognized associated with our investments in LIHTC partnerships for the three and six months ended June 30, 2017 and June 30, 2016:

| (dollars in thousands)                                     | Three<br>Months<br>Ended<br>June 30,<br>2017 | Three<br>Months<br>Ended<br>June 30,<br>2016 | Six<br>Months<br>Ended<br>June 30,<br>2017 | Six<br>Months<br>Ended<br>June 30,<br>2016 |
|--|--|--|--|--|
| Cost method:   |  |  |  |  |
| Amortization expense recognized in other operating expense | \$ 223                                       | \$ 258                                       | \$ 456                                     | \$ 515                                     |
| Tax credits recognized in income tax expense               | 260  | 292  | 526  | 585  |



## 8. CORE DEPOSIT PREMIUM AND MORTGAGE SERVICING RIGHTS

The following table presents changes in core deposit premium and mortgage servicing rights for the six months ended June 30, 2017:

| (dollars in thousands)       | Core               | Mortgage            | Total     |
|------------------------------|--------------------|---------------------|-----------|
|                              | Deposit<br>Premium | Servicing<br>Rights |           |
| Balance, beginning of period | \$ 4,680           | \$ 15,779           | \$ 20,459 |
| Additions                    | —                  | 1,220               | 1,220     |
| Amortization                 | (1,337 )           | (1,067 )            | (2,404 )  |
| Balance, end of period       | \$ 3,343           | \$ 15,932           | \$ 19,275 |

Income generated as the result of new mortgage servicing rights is reported as gains on sales of loans and totaled \$0.6 million and \$1.2 million for the three and six months ended June 30, 2017, compared to \$0.7 million and \$1.2 million for the three and six months ended June 30, 2016.

Amortization of mortgage servicing rights was \$0.5 million and \$1.1 million for the three and six months ended June 30, 2017, compared to \$1.8 million and \$3.3 million for the three and six months ended June 30, 2016.

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

| (dollars in thousands)                         | Six Months Ended<br>June 30, |   |           |   |
|--|------------------------------|---|-----------|---|
|  | 2017                         |   | 2016      |   |
| Fair market value, beginning of period         | \$ 18,087                    |   | \$ 18,345 |   |
| Fair market value, end of period               | 17,024                       |   | 16,123    |   |
| Weighted average discount rate                 | 9.5                          | % | 9.5       | % |
| Forecasted constant prepayment rate assumption | 16.1                         |   | 16.5      |   |

The gross carrying value and accumulated amortization related to our core deposit premium and mortgage servicing rights are presented below:

| (dollars in thousands)    | June 30, 2017              |                             |                          | December 31, 2016          |                             |                          |
|---------------------------|----------------------------|-----------------------------|--------------------------|----------------------------|-----------------------------|--------------------------|
|                           | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Net<br>Carrying<br>Value | Gross<br>Carrying<br>Value | Accumulated<br>Amortization | Net<br>Carrying<br>Value |
| Core deposit premium      | \$ 44,642                  | \$ (41,299 )                | \$ 3,343                 | \$ 44,642                  | \$ (39,962 )                | \$ 4,680                 |
| Mortgage servicing rights | 63,269                     | (47,337 )                   | 15,932                   | 62,049                     | (46,270 )                   | 15,779                   |
| Total                     | \$ 107,911                 | \$ (88,636 )                | \$ 19,275                | \$ 106,691                 | \$ (86,232 )                | \$ 20,459                |

Based on the core deposit premium and mortgage servicing rights held as of June 30, 2017, estimated amortization expense for the remainder of fiscal year 2017, the next five succeeding fiscal years and all years thereafter are as follows:

| (dollars in thousands) | Estimated Amortization Expense |                                 |           |
|------------------------|--------------------------------|---------------------------------|-----------|
|                        | Core<br>Deposit<br>Premium     | Mortgage<br>Servicing<br>Rights | Total     |
| 2017 (remainder)       | \$ 1,337                       | \$ 1,293                        | \$ 2,630  |
| 2018                   | 2,006                          | 2,148                           | 4,154     |
| 2019                   | —                              | 1,767                           | 1,767     |
| 2020                   | —                              | 1,448                           | 1,448     |
| 2021                   | —                              | 1,201                           | 1,201     |
| 2022                   | —                              | 1,039                           | 1,039     |
| Thereafter             | —                              | 7,036                           | 7,036     |
|                        | \$ 3,343                       | \$ 15,932                       | \$ 19,275 |

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

## 9. DERIVATIVES

We utilize various designated and undesignated derivative financial instruments to reduce our exposure to movements in interest rates including interest rate swaps, interest rate lock commitments and forward sale commitments. We measure all derivatives at fair value on our consolidated balance sheet. In each reporting period, we record the derivative instruments in other assets or other liabilities depending on whether the derivatives are in an asset or liability position. For derivative instruments that are designated as cash flow hedging instruments, we record the effective portion of the changes in the fair value of the derivative in AOCI, net of tax, until earnings are affected by the variability of cash flows of the hedged transaction. We immediately recognize the portion of the gain or loss in the fair value of the derivative that represents hedge ineffectiveness in current period earnings. For derivative instruments that are not designated as hedging instruments, changes in the fair value of the derivative are included in current period earnings. At June 30, 2017, we were not party to any derivatives designated as part of a fair value or cash flow hedge.

### Interest Rate Lock and Forward Sale Commitments

We enter into interest rate lock commitments on certain mortgage loans that are intended to be sold. To manage interest rate risk on interest rate lock commitments, we also enter into forward loan sale commitments. The interest rate locks and forward loan sale commitments are accounted for as undesignated derivatives and are recorded at their respective fair values in other assets or other liabilities, with changes in fair value recorded in current period earnings. These instruments serve to reduce our exposure to movements in interest rates. At June 30, 2017, we were a party to interest rate lock and forward sale commitments on \$3.3 million and \$15.1 million of mortgage loans, respectively.

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

| Derivatives Financial Instruments Not Designated<br>as Hedging Instruments<br><br>(dollars in thousands) | Balance Sheet<br>Location           | Asset Derivatives<br>Fair Value at |                      | Liability Derivatives<br>Fair Value at |                      |
|--|-------------------------------------|------------------------------------|----------------------|--|----------------------|
|  |                                     | June<br>30,<br>2017                | December<br>31, 2016 | June<br>30,<br>2017                    | December<br>31, 2016 |
| Interest rate lock and forward sale commitments  | Other assets / other<br>liabilities | \$ 51                              | \$ 260               | \$ 36                                  | \$ 118               |

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

| Derivatives Financial Instruments<br>Not Designated as Hedging Instruments<br>(dollars in thousands) | Location of Gain (Loss)<br>Recognized in<br>Earnings on Derivatives | Amount of Gain (Loss)<br>Recognized in<br>Earnings on Derivatives |
|--|---|---|
| Three Months Ended June 30, 2017   |   |   |
| Interest rate lock and forward sale commitments  | Mortgage banking income   | \$ 80   |
| Loans held for sale  | Other income  | (3 )  |
| Three Months Ended June 30, 2016   |   |   |
| Interest rate lock and forward sale commitments  | Mortgage banking income   | (29 )   |
| Six Months Ended June 30, 2017   |   |   |
| Interest rate lock and forward sale commitments  | Mortgage banking income   | (127 )  |
| Loans held for sale  | Other income  | (3 )  |
| Six Months Ended June 30, 2016   |   |   |
| Interest rate lock and forward sale commitments  | Mortgage banking income   | (108 )  |

#### 10. SHORT-TERM BORROWINGS AND LONG-TERM DEBT

The bank is a member of the Federal Home Loan Bank of Des Moines (the "FHLB") and maintained a \$1.47 billion line of credit as of June 30, 2017, compared to \$1.41 billion at December 31, 2016. At June 30, 2017, \$1.47 billion was undrawn under this arrangement, compared to \$1.28 billion at December 31, 2016. There were no short-term borrowings under this arrangement at June 30, 2017, compared to \$135.0 million at December 31, 2016. There were no long-term borrowings under this arrangement at June 30, 2017 and December 31, 2016. FHLB advances available at June 30, 2017 were secured by certain real estate loans with a carrying value of \$1.91 billion in accordance with the collateral provisions of the Advances, Security and Deposit Agreement with the FHLB.

At June 30, 2017 and December 31, 2016, our bank had additional unused borrowings available at the Federal Reserve discount window of \$68.6 million and \$63.7 million, respectively. As of June 30, 2017 and December 31, 2016, certain commercial and commercial real estate loans with a carrying value totaling \$128.7 million and \$129.9 million, respectively, were pledged as collateral on our line of credit with the Federal Reserve discount window. The Federal Reserve does not have the right to sell or repledge these loans.

#### 11. EQUITY

As a Hawaii state-chartered bank, Central Pacific Bank may only pay dividends to the extent it has retained earnings as defined under Hawaii banking law ("Statutory Retained Earnings"), which differs from GAAP retained earnings. As of June 30, 2017, the bank had Statutory Retained Earnings of \$88.6 million.

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



In January 2016, the Board of Directors authorized the repurchase of up to \$30.0 million of the Company's common stock from time to time in the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase program (the "2016 Repurchase Plan"). In January 2017, prior to the 2017 Repurchase Plan being approved, 1,750 shares of common stock, at a cost of \$0.1 million, were repurchased under the 2016 Repurchase Plan.

On January 24, 2017, the Board of Directors also authorized the repurchase of up to \$30.0 million of the Company's common stock from time to time in the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase program (the "2017 Repurchase Plan"). The 2017 Repurchase Plan replaces and supersedes in its entirety the 2016 Repurchase

Plan. In the six months ended June 30, 2017, 360,621 shares of common stock, at a cost of \$11.2 million, were repurchased under the 2017 Repurchase Plan.

## 12. MORTGAGE BANKING INCOME

Noninterest income from the Company's mortgage banking activities include the following components for the periods indicated:

| (dollars in thousands)                        | Three Months<br>Ended<br>June 30, |          | Six Months<br>Ended<br>June 30, |          |
|---|-----------------------------------|----------|---------------------------------|----------|
|   | 2017                              | 2016     | 2017                            | 2016     |
| Mortgage banking income:                      |                                   |          |                                 |          |
| Loan servicing fees                           | \$1,340                           | \$1,362  | \$2,698                         | \$2,724  |
| Amortization of mortgage servicing rights     | (547 )                            | (1,755 ) | (1,067 )                        | (3,264 ) |
| Gain on sale of residential mortgage loans    | 1,084                             | 1,845    | 2,396                           | 3,311    |
| Unrealized gain (loss) on interest rate locks | 80                                | (29 )    | (127 )                          | (108 )   |
| Total mortgage banking income                 | \$1,957                           | \$1,423  | \$3,900                         | \$2,663  |

## 13. SHARE-BASED COMPENSATION

### Restricted Stock Awards and Units

The table below presents the activity of restricted stock awards and units for the six months ended June 30, 2017:

|   | Shares    | Weighted<br>Average<br>Grant Date<br>Fair Value |
|---|-----------|---|
| Non-vested restricted stock awards and units, beginning of period | 437,697   | \$ 22.01  |
| Changes during the period:  |           |   |
| Granted   | 103,746   | 31.69   |
| Vested  | (117,286) | 19.08   |
| Forfeited   | (18,729 ) | 24.72   |
| Non-vested restricted stock awards and units, end of period       | 405,428   | 25.21   |

## 14. PENSION AND SUPPLEMENTAL EXECUTIVE RETIREMENT PLANS

Central Pacific Bank has a defined benefit retirement plan (the "Pension Plan") which covers certain eligible employees. The plan was curtailed effective December 31, 2002, and accordingly, plan benefits were fixed as of that date. The following table sets forth the components of net periodic benefit cost for the Pension Plan for the periods indicated:

| (dollars in thousands) | Three<br>Months<br>Ended<br>June 30, |       | Six Months<br>Ended<br>June 30, |       |
|------------------------|--------------------------------------|-------|---------------------------------|-------|
|                        | 2017                                 | 2016  | 2017                            | 2016  |
| Interest cost          | \$233                                | \$344 | \$462                           | \$687 |

|                                    |        |        |        |        |
|------------------------------------|--------|--------|--------|--------|
| Expected return on plan assets     | (264 ) | (439 ) | (528 ) | (878 ) |
| Amortization of net actuarial loss | 300    | 354    | 596    | 708    |
| Net periodic cost                  | \$269  | \$259  | \$530  | \$517  |

Our bank also established Supplemental Executive Retirement Plans ("SERPs"), which provide certain (current and former) officers of our bank with supplemental retirement benefits. We have not entered into a SERP since December 31, 2008.

In the second quarter of 2017, the Company settled a portion of the SERP obligation of a former executive. As a result of the settlement, the Company remeasured the related SERP obligation and net periodic benefit cost and recognized a pro-rata net actuarial loss of \$0.1 million in SERP expense and other comprehensive income.

The following table sets forth the components of net periodic benefit cost for the SERPs for the periods indicated:

|   | Three<br>Months<br>Ended<br>June 30, |       | Six Months<br>Ended<br>June 30, |       |
|---|--------------------------------------|-------|---------------------------------|-------|
| (dollars in thousands)                    | 2017                                 | 2016  | 2017                            | 2016  |
| Interest cost                             | \$100                                | \$117 | \$215                           | \$233 |
| Amortization of net actuarial loss        | 25                                   | 12    | 51                              | 25    |
| Amortization of net transition obligation | 5                                    | 4     | 9                               | 8     |
| Amortization of prior service cost        | 4                                    | 5     | 8                               | 10    |
| Settlement                                | 138                                  | —     | 138                             | —     |
| Net periodic cost                         | \$272                                | \$138 | \$421                           | \$276 |

#### 15. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The following tables present the components of other comprehensive income for the three and six months ended June 30, 2017 and 2016, by component:

| (dollars in thousands)  | Before Tax | Tax Effect | Net of Tax |
|---|------------|------------|------------|
| Three Months Ended June 30, 2017                                    |            |            |            |
| Net unrealized gains on investment securities:                      |            |            |            |
| Net unrealized gains arising during the period                      | \$ 3,001   | \$ 1,193   | \$ 1,808   |
| Less: Reclassification adjustment for losses realized in net income | 1,640      | 653        | 987        |
| Net unrealized gains on investment securities                       | 4,641      | 1,846      | 2,795      |
| Defined benefit plans:  |            |            |            |
| Amortization of net actuarial loss                                  | 325        | 222        | 103        |
| Amortization of net transition obligation                           | 5          | 2          | 3          |
| Amortization of prior service cost                                  | 4          | 2          | 2          |
| Settlement  | 138        | 56         | 82         |
| Defined benefit plans, net  | 472        | 282        | 190        |
| Other comprehensive income  | \$ 5,113   | \$ 2,128   | \$ 2,985   |

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| (dollars in thousands)  | Before Tax | Tax Effect | Net of Tax |
|---|------------|------------|------------|
| Three Months Ended June 30, 2016                                    |            |            |            |
| Net unrealized gains on investment securities:                      |            |            |            |
| Net unrealized gains arising during the period                      | \$ 9,737   | \$ 3,871   | \$ 5,866   |
| Less: Reclassification adjustment for losses realized in net income | —          | —          | —          |
| Net unrealized gains on investment securities                       | 9,737      | 3,871      | 5,866      |

|   |           |          |          |
|---|-----------|----------|----------|
| Defined benefit plans:                    |           |          |          |
| Amortization of net actuarial loss        | 366       | 124      | 242      |
| Amortization of net transition obligation | 4         | 1        | 3        |
| Amortization of prior service cost        | 5         | 1        | 4        |
| Defined benefit plans, net                | 375       | 126      | 249      |
| Other comprehensive income                | \$ 10,112 | \$ 3,997 | \$ 6,115 |

| (dollars in thousands)  | Before Tax | Tax Effect | Net of Tax |
|---|------------|------------|------------|
| Six Months Ended June 30, 2017                                      |            |            |            |
| Net unrealized gains on investment securities:                      |            |            |            |
| Net unrealized gains arising during the period                      | \$ 6,528   | \$ 2,596   | \$ 3,932   |
| Less: Reclassification adjustment for losses realized in net income | 1,640      | 653        | 987        |
| Net unrealized gains on investment securities                       | 8,168      | 3,249      | 4,919      |

|  |          |          |          |
|--|----------|----------|----------|
| Defined benefit plans:                         |          |          |          |
| Net actuarial losses arising during the period | (1,042 ) | (415 )   | (627 )   |
| Amortization of net actuarial loss             | 647      | 287      | 360      |
| Amortization of net transition obligation      | 9        | 3        | 6        |
| Amortization of prior service cost             | 8        | 3        | 5        |
| Settlement                                     | 138      | 56       | 82       |
| Defined benefit plans, net                     | (240 )   | (66 )    | (174 )   |
| Other comprehensive income                     | \$ 7,928 | \$ 3,183 | \$ 4,745 |

| (dollars in thousands)  | Before Tax | Tax Effect | Net of Tax |
|---|------------|------------|------------|
| Six Months Ended June 30, 2016                                      |            |            |            |
| Net unrealized gains on investment securities:                      |            |            |            |
| Net unrealized gains arising during the period                      | \$ 29,420  | \$ 11,701  | \$ 17,719  |
| Less: Reclassification adjustment for losses realized in net income | —          | —          | —          |
| Net unrealized gains on investment securities                       | 29,420     | 11,701     | 17,719     |

|  |           |           |           |
|--|-----------|-----------|-----------|
| Defined benefit plans:                         |           |           |           |
| Net actuarial losses arising during the period | —         | —         | —         |
| Amortization of net actuarial loss             | 733       | 248       | 485       |
| Amortization of net transition obligation      | 8         | 2         | 6         |
| Amortization of prior service cost             | 10        | 2         | 8         |
| Defined benefit plans, net                     | 751       | 252       | 499       |
| Other comprehensive income                     | \$ 30,171 | \$ 11,953 | \$ 18,218 |



The following tables present the changes in each component of accumulated other comprehensive income (loss) ("AOCI"), net of tax, for the three and six months ended June 30, 2017 and 2016:

| (dollars in thousands)                              | Investment<br>Securities | Defined<br>Benefit<br>Plans | Accumulated<br>Other<br>Comprehensive<br>Income |
|---|--------------------------|-----------------------------|---|
| Three Months Ended June 30, 2017                    |                          |                             |   |
| Balance at beginning of period                      | \$ 6,853                 | \$(6,614)                   | \$ 239  |
| Other comprehensive income before reclassifications | 1,808                    | —                           | 1,808   |
| Amounts reclassified from AOCI                      | 987                      | 190                         | 1,177   |
| Total other comprehensive income                    | 2,795                    | 190                         | 2,985   |
| Balance at end of period                            | \$ 9,648                 | \$(6,424)                   | \$ 3,224  |

| (dollars in thousands)                              | Investment<br>Securities | Defined<br>Benefit<br>Plans | Accumulated<br>Other<br>Comprehensive<br>Income |
|---|--------------------------|-----------------------------|---|
| Three Months Ended June 30, 2016                    |                          |                             |   |
| Balance at beginning of period                      | \$ 21,034                | \$(8,728)                   | \$ 12,306                                       |
| Other comprehensive income before reclassifications | 5,866                    | —                           | 5,866   |
| Amounts reclassified from AOCI                      | —                        | 249                         | 249   |
| Total other comprehensive income                    | 5,866                    | 249                         | 6,115   |
| Balance at end of period                            | \$ 26,900                | \$(8,479)                   | \$ 18,421                                       |

| (dollars in thousands)                            | Investment<br>Securities | Defined<br>Benefit<br>Plans | Accumulated<br>Other<br>Comprehensive<br>Income |
|---|--------------------------|-----------------------------|---|
| Six Months Ended June 30, 2017                    |                          |                             |   |
| Balance at beginning of period                    | \$ 4,729                 | \$(6,250)                   | \$ (1,521)                                      |
| Other comprehensive loss before reclassifications | 3,932                    | (627)                       | 3,305   |
| Amounts reclassified from AOCI                    | 987                      | 453                         | 1,440   |
| Total other comprehensive income (loss)           | 4,919                    | (174)                       | 4,745   |
| Balance at end of period                          | \$ 9,648                 | \$(6,424)                   | \$ 3,224  |

| (dollars in thousands)                              | Investment<br>Securities | Defined<br>Benefit<br>Plans | Accumulated<br>Other<br>Comprehensive<br>Income |
|---|--------------------------|-----------------------------|---|
| Six Months Ended June 30, 2016                      |                          |                             |   |
| Balance at beginning of period                      | \$ 9,181                 | \$(8,978)                   | \$ 203  |
| Other comprehensive income before reclassifications | 17,719                   | —                           | 17,719  |
| Amounts reclassified from AOCI                      | —                        | 499                         | 499   |
| Total other comprehensive income                    | 17,719                   | 499                         | 18,218  |
| Balance at end of period                            | \$ 26,900                | \$(8,479)                   | \$ 18,421                                       |





The following table presents the amounts reclassified out of each component of AOCI for the three and six months ended June 30, 2017 and 2016:

| Details about AOCI Components<br>(dollars in thousands)                                     | Amount Reclassified from AOCI    |           | Affected Line Item in the Statement<br>Where Net Income is Presented |
|---|----------------------------------|-----------|--|
|   | Three months ended June 30, 2017 | 2016      |  |
| Sale of investment securities available for sale  | \$ (1,640 )                      | \$ —      | Investment securities losses   |
|   | 653                              | —         | Tax benefit  |
|   | \$ (987 )                        | \$ —      | Net of tax   |
| Amortization of defined benefit retirement and supplemental executive retirement plan items |                                  |           |  |
| Net actuarial loss  | \$ (325 )                        | \$ (366 ) | (1)  |
| Net transition obligation   | (5 )                             | (4 )      | (1)  |
| Prior service cost  | (4 )                             | (5 )      | (1)  |
| Settlement  | (138 )                           | —         | (1)  |
|   | (472 )                           | (375 )    | Total before tax   |
|   | 282                              | 126       | Tax benefit  |
|   | \$ (190 )                        | \$ (249 ) | Net of tax   |
| Total reclassifications for the period  | \$ (1,177 )                      | \$ (249 ) | Net of tax   |
| Amount Reclassified from AOCI   |                                  |           |  |
| Details about AOCI Components<br>(dollars in thousands)                                     | Six months ended June 30,        |           | Affected Line Item in the Statement<br>Where Net Income is Presented |
|   | 2017                             | 2016      |  |
| Sale of investment securities available for sale  | \$ (1,640 )                      | \$ —      | Investment securities losses   |
|   | 653                              | —         | Tax benefit  |
|   | \$ (987 )                        | \$ —      | Net of tax   |
| Amortization of defined benefit retirement and supplemental executive retirement plan items |                                  |           |  |
| Net actuarial loss  | \$ (647 )                        | \$ (733 ) | (1)  |
| Net transition obligation   | (9 )                             | (8 )      | (1)  |
| Prior service cost  | (8 )                             | (10 )     | (1)  |
| Settlement  | (138 )                           | —         | (1)  |
|   | (802 )                           | (751 )    | Total before tax   |
|   | 349                              | 252       | Tax benefit  |
|   | \$ (453 )                        | \$ (499 ) | Net of tax   |
| Total reclassifications for the period  | \$ (1,440 )                      | \$ (499 ) | Net of tax   |

(1) These AOCI components are included in the computation of net periodic pension cost (see Note 14 - Pension and Supplemental Executive Retirement Plans for additional details).

## 16. EARNINGS PER SHARE

The following table presents the information used to compute basic and diluted earnings per common share for the periods indicated:

| (dollars in thousands, except per share data)        | Three Months Ended June 30, |            | Six Months Ended June 30, |            |
|--|-----------------------------|------------|---------------------------|------------|
|  | 2017                        | 2016       | 2017                      | 2016       |
| Net income   | \$12,025                    | \$ 12,137  | \$25,104                  | \$ 23,318  |
| Weighted average shares outstanding - basic          | 30,568,247                  | 31,060,593 | 30,641,165                | 31,162,013 |
| Dilutive effect of employee stock options and awards | 235,478                     | 201,932    | 238,758                   | 197,555    |
| Weighted average shares outstanding - diluted        | 30,803,725                  | 31,262,525 | 30,879,923                | 31,359,568 |
| Basic earnings per common share                      | \$0.39                      | \$ 0.39    | \$0.82                    | \$ 0.75    |
| Diluted earnings per common share                    | \$0.39                      | \$ 0.39    | \$0.81                    | \$ 0.74    |

A total of 33 and 25 potentially dilutive shares of common stock have been excluded from the dilutive share calculation for the three and six months ended June 30, 2017, respectively, as their effect was anti-dilutive, compared to 8,227 and 9,439 potentially dilutive shares of common stock for the three and six months ended June 30, 2016, respectively.

## 17. FAIR VALUE OF FINANCIAL ASSETS AND LIABILITIES

## Disclosures about Fair Value of Financial Instruments

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

## Short-Term Financial Instruments

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

## Investment Securities

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

## Loans

Fair values of loans are estimated based on discounted cash flows of portfolios of loans with similar financial characteristics including the type of loan, interest terms and repayment history. Fair values are calculated by discounting scheduled cash flows through estimated maturities using estimated market discount rates. Estimated market discount rates are reflective of credit and interest rate risks inherent in the Company's various loan types and are derived from available market information, as well as specific borrower information. The fair value of loans are not based on the notion of exit price.

### Loans Held for Sale

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

### Mortgage Servicing Rights

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

### Other Interest-Earning Assets

The equity investment in common stock of the FHLB, which is redeemable for cash at par value, is reported at its par value.

### Deposit Liabilities

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

### Long-Term Debt

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

### Off-Balance Sheet Financial Instruments

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

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

### Limitations

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



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

| (dollars in thousands)                                     | Carrying Amount | Estimated Fair Value | Fair Value Measurement Using                                   |   |   |
|--|-----------------|----------------------|--|---|---|
|  |                 |                      | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| June 30, 2017  |                 |                      |  |   |   |
| Financial assets   |                 |                      |  |   |   |
| Cash and due from banks                                    | \$ 85,975       | \$ 85,975            | \$ 85,975  | \$ —  | \$ —                                      |
| Interest-bearing deposits in other banks                   | 54,576          | 54,576               | 54,576   | —   | —   |
| Investment securities                                      | 1,520,483       | 1,519,229            | 809  | 1,506,231                                     | 12,189                                    |
| Loans held for sale  | 13,288          | 13,288               | —  | 13,288  | —   |
| Net loans and leases                                       | 3,538,907       | 3,505,125            | —  | 28,058  | 3,477,067                                 |
| Mortgage servicing rights                                  | 15,932          | 17,024               | —  | —   | 17,024                                    |
| Federal Home Loan Bank stock                               | 6,492           | 6,492                | 6,492  | —   | —   |
| Accrued interest receivable                                | 15,636          | 15,636               | 15,636   | —   | —   |
| Financial liabilities                                      |                 |                      |  |   |   |
| Deposits:  |                 |                      |  |   |   |
| Noninterest-bearing demand                                 | 1,383,754       | 1,383,754            | 1,383,754  | —   | —   |
| Interest-bearing demand and savings and money market       | 2,371,064       | 2,371,064            | 2,371,064  | —   | —   |
| Time   | 1,131,564       | 1,127,639            | —  | —   | 1,127,639                                 |
| Short-term borrowings                                      | —               | —                    | —  | —   | —   |
| Long-term debt   | 92,785          | 69,265               | —  | 69,265  | —   |
| Accrued interest payable (included in other liabilities)   | 2,504           | 2,504                | 2,504  | —   | —   |
| Off-balance sheet financial instruments                    |                 |                      |  |   |   |
| Commitments to extend credit                               | 890,045         | 1,123                | —  | 1,123   | —   |
| Standby letters of credit and financial guarantees written | 19,329          | 290                  | —  | 290   | —   |
| Derivatives:   |                 |                      |  |   |   |
| Interest rate lock commitments                             | 3,347           | (15 )                | —  | (15 )   | —   |
| Forward sale commitments                                   | 15,145          | 30                   | —  | 30  | —   |

| (dollars in thousands)                                     | Carrying Amount | Estimated Fair Value | Fair Value Measurement Using                                   |   |   |
|--|-----------------|----------------------|--|---|---|
|  |                 |                      | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| December 31, 2016  |                 |                      |  |   |   |
| Financial assets   |                 |                      |  |   |   |
| Cash and due from banks                                    | \$ 75,272       | \$ 75,272            | \$ 75,272  | \$ —  | \$ —                                      |
| Interest-bearing deposits in other banks                   | 9,069           | 9,069                | 9,069  | —   | —   |
| Investment securities                                      | 1,461,515       | 1,458,213            | 660  | 1,445,357                                     | 12,196                                    |
| Loans held for sale  | 31,881          | 31,881               | —  | 31,881  | —   |
| Net loans and leases                                       | 3,468,259       | 3,426,976            | —  | 30,723  | 3,396,253                                 |
| Mortgage servicing rights                                  | 15,779          | 18,087               | —  | —   | 18,087                                    |
| Federal Home Loan Bank stock                               | 11,572          | 11,572               | 11,572   | —   | —   |
| Accrued interest receivable                                | 15,675          | 15,675               | 15,675   | —   | —   |
| Financial liabilities                                      |                 |                      |  |   |   |
| Deposits:  |                 |                      |  |   |   |
| Noninterest-bearing demand                                 | 1,265,246       | 1,265,246            | 1,265,246  | —   | —   |
| Interest-bearing demand and savings and money market       | 2,253,591       | 2,253,591            | 2,253,591  | —   | —   |
| Time   | 1,089,364       | 1,088,436            | —  | —   | 1,088,436                                 |
| Short-term borrowings                                      | 135,000         | 135,000              | —  | 135,000                                       | —   |
| Long-term debt   | 92,785          | 68,186               | —  | 68,186  | —   |
| Accrued interest payable (included in other liabilities)   | 1,556           | 1,556                | 1,556  | —   | —   |
| Off-balance sheet financial instruments                    |                 |                      |  |   |   |
| Commitments to extend credit                               | 825,304         | 1,046                | —  | 1,046   | —   |
| Standby letters of credit and financial guarantees written | 16,043          | 241                  | —  | 241   | —   |
| Derivatives:   |                 |                      |  |   |   |
| Interest rate lock commitments                             | 879             | 6                    | —  | 6   | —   |
| Forward sale commitments                                   | 32,497          | 136                  | —  | 136   | —   |

#### Fair Value Measurements

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

Level 1 — Valuation is based upon quoted prices (unadjusted) for identical assets or liabilities traded in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available.

Level 2 — Valuation is based upon quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

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

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

We use fair value measurements to record adjustments to certain financial assets and liabilities and to determine fair value disclosures. Available for sale securities and derivatives are recorded at fair value on a recurring basis. From time to time, we



may be required to record other financial assets at fair value on a nonrecurring basis such as loans held for sale, impaired loans and mortgage servicing rights. These nonrecurring fair value adjustments typically involve application of the lower of cost or fair value accounting or write-downs of individual assets.

There were no transfers of financial assets and liabilities between Level 1 and Level 2 of the fair value hierarchy during the three and six months ended June 30, 2017.

The following tables presents the fair value of assets and liabilities measured on a recurring basis as of June 30, 2017 and December 31, 2016:

| (dollars in thousands)  | Fair Value  | Fair Value at Reporting Date Using   |  |  |
|---|-------------|--|--|--|
|   |             | Quoted<br>Prices in<br>Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Markets<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| June 30, 2017   |             |  |  |  |
| Available for sale securities:  |             |  |  |  |
| Debt securities:  |             |  |  |  |
| States and political subdivisions   | \$185,682   | \$ —   | \$ 173,493   | \$ 12,189  |
| Corporate securities  | 94,072      | —  | 94,072   | —  |
| U.S. Treasury obligations and direct obligations of U.S Government agencies | 26,506      | —  | 26,506   | —  |
| Mortgage-backed securities:   |             |  |  |  |
| Residential - U.S. Government sponsored entities                            | 788,338     | —  | 788,338  | —  |
| Commercial - U.S. Government agencies and sponsored entities                | 32,548      | —  | 32,548   | —  |
| Residential - Non-government agencies                                       | 48,954      | —  | 48,954   | —  |
| Commercial - Non-government agencies  | 138,986     | —  | 138,986  | —  |
| Other   | 809         | 809  | —  | —  |
| Total available for sale securities   | 1,315,895   | 809  | 1,302,897  | 12,189   |
| Derivatives: Interest rate lock and forward sale commitments                | 15          | —  | 15   | —  |
| Total   | \$1,315,910 | \$ 809   | \$ 1,302,912   | \$ 12,189  |

| (dollars in thousands)                           | Fair Value | Fair Value at Reporting Date Using   |  |  |
|--|------------|--|--|--|
|  |            | Quoted<br>Prices in<br>Active<br>Markets<br>for Identical<br>Assets<br>(Level 1) | Significant<br>Other<br>Markets<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
| December 31, 2016                                |            |  |  |  |
| Available for sale securities:                   |            |  |  |  |
| Debt securities:                                 |            |  |  |  |
| States and political subdivisions                | \$185,041  | \$ —   | \$ 172,845   | \$ 12,196  |
| Corporate securities                             | 99,389     | —  | 99,389   | —  |
| Mortgage-backed securities:                      |            |  |  |  |
| Residential - U.S. Government sponsored entities | 769,986    | —  | 769,986  | —  |
| Residential - Non-government agencies            | 51,547     | —  | 51,547   | —  |

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|  |             |        |              |           |
|--|-------------|--------|--------------|-----------|
| Commercial - Non-government agencies                         | 137,224     | —      | 137,224      | —         |
| Other  | 660         | 660    | —            | —         |
| Total available for sale securities                          | 1,243,847   | 660    | 1,230,991    | 12,196    |
| Derivatives: Interest rate lock and forward sale commitments | 142         | —      | 142          | —         |
| Total  | \$1,243,989 | \$ 660 | \$ 1,231,133 | \$ 12,196 |

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For the six months ended June 30, 2017 and 2016, the changes in Level 3 assets and liabilities measured at fair value on a recurring basis are summarized as follows:

| (dollars in thousands)                                     | Available for Sale<br>Debt Securities:<br>States and<br>Political<br>Subdivisions |
|--|---|
| Balance at December 31, 2016                               | \$ 12,196   |
| Principal payments received                                | (183 )  |
| Unrealized net gain included in other comprehensive income | 176   |
| Balance at June 30, 2017                                   | \$ 12,189   |
| Balance at December 31, 2015                               | \$ 12,479   |
| Principal payments received                                | (166 )  |
| Unrealized net gain included in other comprehensive income | 1,002   |
| Balance at June 30, 2016                                   | \$ 13,315   |

Within the state and political subdivisions debt securities category, the Company holds four mortgage revenue bonds issued by the City & County of Honolulu with an aggregate fair value of \$12.2 million and \$13.3 million at June 30, 2017 and June 30, 2016, respectively. The Company estimates the fair value of its mortgage revenue bonds by using a discounted cash flow model to calculate the present value of estimated future principal and interest payments.

The significant unobservable input used in the fair value measurement of the Company's mortgage revenue bonds is the weighted average discount rate. As of June 30, 2017, the weighted average discount rate utilized was 4.54%, compared to 3.00% at December 31, 2016, which was derived by incorporating a credit spread over the FHLB Fixed-Rate Advance curve. Significant increases (decreases) in the weighted average discount rate could result in a significantly lower (higher) fair value measurement.

The following table presents the fair value of assets measured on a nonrecurring basis and the level of valuation assumptions used to determine the respective fair values as of June 30, 2017 and December 31, 2016:

| (dollars in thousands)    | Fair Value | Fair Value Measurements Using   |  | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|---------------------------|------------|---|--|--|
|                           |            | Quoted<br>Prices<br>in Active<br>Markets<br>for<br>Identical<br>(Level 1) | Significant<br>Observable<br>Inputs<br>(Level 2) |  |
| June 30, 2017             |            |   |  |  |
| Impaired loans (1)        | \$ 28,058  | \$ —  | \$ 28,058  | \$ —   |
| Mortgage servicing rights | 17,024     | —   | —  | 17,024   |
| Other real estate (2)     | 1,008      | —   | 1,008  | —  |
| December 31, 2016         |            |   |  |  |
| Impaired loans (1)        | \$ 30,723  | \$ —  | \$ 30,723  | \$ —   |
| Mortgage servicing rights | 18,087     | —   | —  | 18,087   |
| Other real estate (2)     | 791        | —   | 791  | —  |

- (1) Represents carrying value and related write-downs of loans for which adjustments are based on agreed upon purchase prices for the loans or the appraised value of the collateral.
- (2) Represents other real estate that is carried at the lower of carrying value or fair value less costs to sell. Fair value is generally based upon independent market prices or appraised values of the collateral.

## 18. SEGMENT INFORMATION

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

The Banking Operations segment includes construction and real estate development lending, commercial lending, residential mortgage lending, indirect auto lending, trust services, retail brokerage services and our retail branch offices, which provide a full range of deposit and loan products, as well as various other banking services. The Treasury segment is responsible for managing the Company's investment securities portfolio and wholesale funding activities. The All Others segment consists of all activities not captured by the Banking Operations or Treasury segments described above and includes activities such as electronic banking, data processing and management of bank owned properties.

The accounting policies of the segments are consistent with the Company's accounting policies that are described in Note 1 - Summary of Significant Accounting Policies to the consolidated financial statements in the Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC. The majority of the Company's net income is derived from net interest income. Accordingly, management focuses primarily on net interest income, rather than gross interest income and expense amounts, in evaluating segment profitability.

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

Segment profits and assets are provided in the following table for the periods indicated.

| (dollars in thousands)                         | Banking<br>Operations | Treasury  | All Others | Total     |
|--|-----------------------|-----------|------------|-----------|
| Three Months Ended June 30, 2017               |                       |           |            |           |
| Net interest income                            | \$ 34,558             | \$ 7,071  | \$ —       | \$ 41,629 |
| Inter-segment net interest income (expense)    | 8,161                 | (6,339 )  | (1,822 )   | —         |
| Credit for loan and lease losses               | 2,282                 | —         | —          | 2,282     |
| Other operating income                         | 5,844                 | (933 )    | 2,959      | 7,870     |
| Other operating expense                        | (14,835 )             | (322 )    | (17,178 )  | (32,335 ) |
| Administrative and overhead expense allocation | (15,021 )             | (228 )    | 15,249     | —         |
| Income before taxes                            | 20,989                | (751 )    | (792 )     | 19,446    |
| Income tax (expense) benefit                   | (7,964 )              | 240       | 303        | (7,421 )  |
| Net income (loss)                              | \$ 13,025             | \$ (511 ) | \$ (489 )  | \$ 12,025 |

| (dollars in thousands)                      | Banking<br>Operations | Treasury | All Others | Total     |
|---|-----------------------|----------|------------|-----------|
| Three Months Ended June 30, 2016            |                       |          |            |           |
| Net interest income                         | \$ 31,985             | \$ 7,624 | \$ —       | \$ 39,609 |
| Inter-segment net interest income (expense) | 9,435                 | (6,900 ) | (2,535 )   | —         |
| Credit for loan and lease losses            | 1,382                 | —        | —          | 1,382     |
| Other operating income                      | 6,493                 | 1,397    | 2,047      | 9,937     |

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|  |           |        |           |           |
|--|-----------|--------|-----------|-----------|
| Other operating expense                        | (14,904 ) | (439 ) | (17,117 ) | (32,460 ) |
| Administrative and overhead expense allocation | (16,709 ) | (194 ) | 16,903    | —         |
| Income before taxes                            | 17,682    | 1,488  | (702 )    | 18,468    |
| Income tax (expense) benefit                   | (6,078 )  | (513 ) | 260       | (6,331 )  |
| Net income (loss)                              | \$ 11,604 | \$ 975 | \$ (442 ) | \$ 12,137 |

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| (dollars in thousands)                         | Banking<br>Operations | Treasury  | All Others  | Total     |
|--|-----------------------|-----------|-------------|-----------|
| Six Months Ended June 30, 2017                 |                       |           |             |           |
| Net interest income                            | \$ 68,648             | \$ 14,236 | \$ —        | \$ 82,884 |
| Inter-segment net interest income (expense)    | 16,088                | (12,529 ) | (3,559 )    | —         |
| Credit for loan and lease losses               | 2,362                 | —         | —           | 2,362     |
| Other operating income                         | 11,568                | 328       | 5,988       | 17,884    |
| Other operating expense                        | (29,853 )             | (710 )    | (33,232 )   | (63,795 ) |
| Administrative and overhead expense allocation | (28,725 )             | (430 )    | 29,155      | —         |
| Income before taxes                            | 40,088                | 895       | (1,648 )    | 39,335    |
| Income tax (expense) benefit                   | (14,504 )             | (324 )    | 597         | (14,231 ) |
| Net income (loss)                              | \$ 25,584             | \$ 571    | \$ (1,051 ) | \$ 25,104 |

| (dollars in thousands)                         | Banking<br>Operations | Treasury  | All Others  | Total     |
|--|-----------------------|-----------|-------------|-----------|
| Six Months Ended June 30, 2016                 |                       |           |             |           |
| Net interest income                            | \$ 62,936             | \$ 15,884 | \$ —        | \$ 78,820 |
| Inter-segment net interest income (expense)    | 19,993                | (13,917 ) | (6,076 )    | —         |
| Credit for loan and lease losses               | 2,129                 | —         | —           | 2,129     |
| Other operating income                         | 12,027                | 2,142     | 4,424       | 18,593    |
| Other operating expense                        | (29,647 )             | (827 )    | (33,352 )   | (63,826 ) |
| Administrative and overhead expense allocation | (28,141 )             | (390 )    | 28,531      | —         |
| Income before taxes                            | 39,297                | 2,892     | (6,473 )    | 35,716    |
| Income tax (expense) benefit                   | (13,644 )             | (1,004 )  | 2,250       | (12,398 ) |
| Net income                                     | \$ 25,653             | \$ 1,888  | \$ (4,223 ) | \$ 23,318 |

| (dollars in thousands)                           | Banking<br>Operations | Treasury     | All Others | Total        |
|--|-----------------------|--------------|------------|--------------|
| At June 30, 2017:                                |                       |              |            |              |
| Investment securities                            | \$ —                  | \$ 1,520,483 | \$ —       | \$ 1,520,483 |
| Loans and leases (including loans held for sale) | 3,605,023             | —            | —          | 3,605,023    |
| Other  | 40,235                | 284,343      | 83,051     | 407,629      |
| Total assets                                     | \$ 3,645,258          | \$ 1,804,826 | \$ 83,051  | \$ 5,533,135 |

| (dollars in thousands)                           | Banking<br>Operations | Treasury     | All Others | Total        |
|--|-----------------------|--------------|------------|--------------|
| At December 31, 2016:                            |                       |              |            |              |
| Investment securities                            | \$ —                  | \$ 1,461,515 | \$ —       | \$ 1,461,515 |
| Loans and leases (including loans held for sale) | 3,556,771             | —            | —          | 3,556,771    |
| Other  | 56,482                | 241,387      | 68,081     | 365,950      |
| Total assets                                     | \$ 3,613,253          | \$ 1,702,902 | \$ 68,081  | \$ 5,384,236 |

## 19. LEGAL PROCEEDINGS

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





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

### Overview

Central Pacific Financial Corp. ("CPF") is a Hawaii corporation and a bank holding company. Our principal business is to serve as a holding company for our bank subsidiary, Central Pacific Bank. We refer to Central Pacific Bank herein as "our bank" or "the bank," and when we say "the Company," "we," "us" or "our," we mean the holding company on a consolidated basis with the bank and our other consolidated subsidiaries.

Central Pacific Bank is a full-service community bank with 35 branches and 84 ATMs located throughout the state of Hawaii. The bank offers a broad range of products and services including accepting time, savings, money market, and demand deposits and originating loans, including commercial loans, construction loans, commercial and residential mortgage loans, and consumer loans.

### Basis of Presentation

Management's discussion and analysis of financial condition and results of operations should be read in conjunction with the accompanying consolidated financial statements under "Part I, Item 1. Financial Statements (Unaudited)." The following discussion should also be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2016 filed with the U.S. Securities and Exchange Commission (the "SEC") on March 1, 2017.

### Critical Accounting Policies and Use of Estimates

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

### Allowance for Loan and Lease Losses

The allowance for loan and lease losses (the "Allowance") is management's estimate of credit losses inherent in our loan and lease portfolio at the balance sheet date. We maintain our Allowance at an amount we expect to be sufficient to absorb probable losses incurred in our loan and lease portfolio. At June 30, 2017, we had an Allowance of \$52.8 million, compared to \$56.6 million at December 31, 2016.

During the fourth quarter of 2016, the Company implemented an enhanced Allowance methodology due to the growth in the portfolio and improved credit quality. Management believes the enhanced methodology provides for greater precision in calculating the Allowance. The following summarizes the key enhancements made to the Allowance methodology:

- Collapsed 128 segments into nine segments. The enhanced methodology uses FDIC Call Report codes to identify the nine segments.
- Expanded the look-back period to 28 quarters to capture a longer economic cycle.
-

Utilized a migration analysis, versus average historical loss rate, to determine the historical loss rates for segments, with the exception of national syndicated loans due to limited loss history and auto dealer purchased portfolios, which are purchased at a premium.

• Applied a segment specific loss emergence period.

• Determined qualitative reserves, calculated at the segment level, considering nine qualitative factors and based on a baseline risk weighting adjusted for current internal and external factors.

• Eliminated the Moody's proxy rate that was applied under the previous methodology.

• Eliminated the unallocated reserve.

These enhancements and continued improvement in portfolio credit quality resulted in a credit to the Provision of \$2.6 million during the fourth quarter of 2016. In the first half of 2017 the Company continued to implement the enhanced Allowance methodology from the fourth quarter of 2016, which together with an increase in recoveries resulted in a \$2.3 million and \$2.4 million credit to the Provision in the three and six months ended June 30, 2017.

The Company's approach to developing the Allowance has three basic elements. These elements include specific reserves for individually impaired loans, a general allowance for loans other than those analyzed as individually impaired, and qualitative adjustments based on environmental and other factors which may be internal or external to the Company.

#### Specific Reserve

Individually impaired loans in all loan categories are evaluated using one of three valuation methods as prescribed under Accounting Standards Codification ("ASC") 310-10, "Fair Value of Collateral, Observable Market Price, or Cash Flow". A loan is generally evaluated for impairment on an individual basis if it meets one or more of the following characteristics: risk-rated as substandard, doubtful or loss, loans on nonaccrual status, troubled debt restructures, or any loan deemed prudent by management to so analyze. If the valuation of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the Allowance or, alternatively, a specific reserve will be established and included in the overall Allowance balance. The Company did not record a specific reserve as of June 30, 2017 and December 31, 2016.

#### General Allowance

In determining the general allowance component of the Allowance, the Company utilizes a comprehensive approach to segment the loan portfolio into homogenous groups. The enhanced methodology segments the portfolio by FDIC Call Report codes. This results in nine segments, and is more consistent with industry practice. For the purpose of determining general allowance loss factors, loss experience is derived from a migration analysis, with the exception of national syndicated loans where an average historical loss rate is applied due to limited historical loss experience. The key inputs to run a migration analysis are the length of the migration period, the dates for the migration periods to start and the number of migration periods used for the analysis. For each migration period, the analysis will determine the outstanding balance in each segment and/or sub-segment at the start of each period. These loans will then be followed for the length of the migration period to identify the amount of associated charge-offs and recoveries. A loss rate for each migration period is calculated using the formula 'net charge-offs over the period divided by beginning loan balance'. The Allowance methodology applies a look back period to January 1, 2010. The Company intends to extend its look back period moving forward.

#### Qualitative Adjustments

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

In recognizing that current and relevant environmental (economic, market or other) conditions that can affect repayment may not yet be fully reflected in historical loss experience, qualitative adjustments are applied to factor in current loan portfolio and market intelligence. These adjustments, which are added to the historical loss rate, consider the nature of the Company's primary markets and are reasonable, consistently determined and appropriately documented. Management reviews the results of the qualitative adjustment quarterly to ensure it is consistent with the trends in the overall economy, and from time to time may make adjustments, if necessary, to ensure directional consistency.

## Loans Held for Sale

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

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

The fair value of loans classified as held for sale are generally based upon quoted prices for similar assets in active markets, acceptance of firm offer letters with agreed upon purchase prices, discounted cash flow models that take into account market observable assumptions, or independent appraisals of the underlying collateral securing the loans. We report the fair values of the non-residential loans classified as held for sale net of applicable selling costs on our consolidated balance sheets. At June 30, 2017 and December 31, 2016, all of our loans held for sale were Hawaii residential mortgage loans.

### Mortgage Servicing Rights

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

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

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

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

### Deferred Tax Assets and Tax Contingencies

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

As of June 30, 2017, we have a valuation allowance on our net DTA of \$2.7 million, which relates to our California state income taxes as we do not expect to generate sufficient income in California to utilize the DTA. Given our six consecutive years of profitability and the expectation of continued profitability, strong asset quality, and well-capitalized position, we

continue to believe that it is more likely than not that our remaining net DTA totaling \$41.3 million at June 30, 2017 will be realized.

The Company establishes income tax contingency reserves for potential tax liabilities related to uncertain tax positions that arise in the normal course of business. Tax benefits are recognized when we determine that it is more likely than not that such benefits will be realized. Where uncertainty exists due to the complexity of income tax statutes and where the potential tax amounts are significant, we generally seek independent tax opinions to support our positions. If our evaluation of the likelihood of the realization of benefits is inaccurate, we could incur additional income tax and interest expense that would adversely impact earnings, or we could receive tax benefits greater than anticipated which would positively impact earnings. The Company did not have any uncertain tax positions as of June 30, 2017 and December 31, 2016.

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

In March 2017, the FASB issued ASU 2017-07, "Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost." ASU 2017-07 requires an entity to present the service cost component of the net periodic benefit cost in the same line item or items in the statement of income (i.e. salaries and employee benefits) as other employee compensation costs arising from services rendered by the pertinent employees during the period. In addition, only the service cost component is eligible for capitalization. The other components of net benefit costs are required to be presented in the statement of income separately from the service cost component (i.e. other operating expense - other). ASU 2017-07 is effective for the Company's reporting period beginning on January 1, 2018. Early adoption is permitted, however the Company does not plan to early adopt. The presentation of the service cost component and the other components of net periodic pension cost and net periodic postretirement benefit cost in the statement of income should be applied retrospectively, while the capitalization of the service cost component of net periodic pension cost and net periodic postretirement benefit cost in assets should be applied prospectively. ASU 2017-07 allows a practical expedient that permits the Company to use the amounts disclosed in its pension and other postretirement benefit plan footnote for the prior comparative periods as the estimation basis for applying the retrospective presentation requirements. We are currently evaluating the potential impact the new standard will have on our consolidated financial statements, but we do not expect the adoption of ASU 2017-07 to have a material impact on our consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, "Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities." ASU 2017-08 shortens the amortization period for certain callable debt securities held at a premium to the earliest call date. ASU 2017-08 does not require an accounting change for securities held at a discount; the discount continues to be amortized to maturity. ASU 2017-08 is effective for the Company's reporting period beginning on January 1, 2018. Early adoption is permitted. ASU 2017-08 should be applied on a modified retrospective basis through a cumulative-effect adjustment directly to retained earnings. We are currently evaluating the potential impact the new standard will have on our consolidated financial statements, but we do not expect the adoption of ASU 2017-08 to have a material impact on our consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, "Compensation-Stock Compensation (Topic 718): Scope of Modification." ASU 2017-09 was issued to provide clarity and reduce both 1) diversity in practice and 2) cost and complexity when applying the guidance in Topic 718, Compensation - Stock Compensation, to a change to the terms or conditions of a share-based payment award. Diversity in practice has arisen in part because some entities apply modification accounting under Topic 718 for modifications to terms and conditions that they consider substantive, but do not when they conclude that particular modifications are not substantive. Others apply modification accounting for any change to an award, except for changes that they consider purely administrative in nature. Still others apply modification accounting when a change to an award changes the fair value, the vesting, or the classification of the award. In practice, it appears that the evaluation of a change in fair value, vesting, or classification may be used to

evaluate whether a change is substantive. ASU 2017-09 include guidance on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. ASU 2017-09 is effective for the the Company's reporting period beginning on January 1, 2018. Early adoption is permitted. ASU 2017-09 should be applied prospectively to an award modified on or after the adoption date. We are currently in the process of evaluating the potential impact the new standard will have on our consolidated financial statements, but we do not expect the adoption of ASU 2017-09 to have a material impact on our consolidated financial statements.

#### Financial Summary

Net income for the three months ended June 30, 2017 was \$12.0 million, or \$0.39 per diluted share, compared to \$12.1 million, or \$0.39 per diluted share for the three months ended June 30, 2016. Net income for the six months ended June 30, 2017 was



\$25.1 million, or \$0.81 per diluted share, compared to \$23.3 million, or \$0.74 per diluted share for the six months ended June 30, 2016.

The following table presents annualized returns on average assets and average shareholders' equity, and basic and diluted earnings per share for the periods indicated.

|  | Three Months<br>Ended<br>June 30,<br>2017 |        | Six Months<br>Ended<br>June 30,<br>2016 |        |
|--|---|--------|---|--------|
| Return on average assets               | 0.88 %                                    | 0.93 % | 0.92 %                                  | 0.90 % |
| Return on average shareholders' equity | 9.32                                      | 9.51   | 9.78                                    | 9.18   |
| Basic earnings per common share        | \$0.39                                    | \$0.39 | \$0.82                                  | \$0.75 |
| Diluted earnings per common share      | 0.39                                      | 0.39   | 0.81                                    | 0.74   |

### Material Trends

While the U.S. economy is in its 8th year of recovery following the downturn, there remains some uncertainty in the U.S. and global macroeconomic environments. Job gains have been moderate and wages have not increased significantly, while inflation has remained below the Federal Reserve's long term objective and business fixed investment remains low. Furthermore, until policy actions of the new U.S. Presidential Administration are solidified, there remains uncertainty in the economic and regulatory environment.

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

In its second quarter of 2017 report, DBEDT projects Hawaii's economy, as measured by the growth of real personal income and real gross state product, will grow steadily at a rate of 2.4% and 1.9% for 2017, respectively. Based on the recent developments in the national and global economy, the performance of Hawaii's tourism industry, the labor market conditions in the state, and growth of personal income and tax revenues, DBEDT expects Hawaii's economy will continue to experience positive growth in 2017.

The Department of Labor and Industrial Relations reported that Hawaii's seasonally adjusted annual unemployment rate improved to 2.7% in June 2017, compared to 3.1% in June 2016. The last time Hawaii's unemployment rate was 2.7% was in June 2007. In addition, Hawaii's unemployment rate is among the lowest in the nation, and remained below the national seasonally adjusted unemployment rate of 4.4%. DBEDT projects Hawaii's seasonally adjusted annual unemployment rate to be at 3.4% in 2017.

Tourism continues to be Hawaii's center of strength and its most significant economic driver. For the fifth straight year, Hawaii's strong visitor industry broke records for visitor arrivals and visitor spending, and through the six months ended June 30, 2017, is on pace for its sixth straight record-breaking year. According to the Hawaii Tourism Authority ("HTA"), 4.6 million visitors visited the state in the six months ended June 30, 2017. This was an increase of 4.3% from the number of visitor arrivals in the six months ended June 30, 2016. The HTA also reported total spending by visitors increased to \$8.4 billion in the six months ended June 30, 2017, or an increase of \$670.6 million, or 8.7%, from the six months ended June 30, 2016. According to DBEDT, total visitor arrivals and visitor spending are expected to increase 2.0% and 5.1% in 2017, respectively.

Real estate lending is a primary focus for us, including residential mortgage, commercial mortgage, and construction loans. As a result, we are dependent on the strength of Hawaii's real estate market. Home sales in Hawaii were strong and Oahu single-family home prices soared to record highs in 2016. These trends continued through the six months ended June 30, 2017. According to the Honolulu Board of Realtors, Oahu unit sales volume increased by 4.4% for single-family homes and 6.0% for condominiums for the six months ended June 30, 2017 compared to the same time period last year. The median sales price for single family homes on Oahu reached an all time high of \$795,000 for the month of June 2017. For the six months ended June 30, 2017, the median sales price for single-family homes on Oahu was \$750,000, representing an increase of 3.2% from \$727,000 in the same prior year period. The median sales price for condominiums on Oahu for the six months ended June 30, 2017 was \$399,000, representing an increase of 3.6% from \$385,000 in the same prior year period. We believe the Hawaii real

estate market will continue to remain strong during the remainder of 2017, however, there can be no assurance that this will occur.

As we have seen in the past, our operating results are significantly impacted by: (i) the economy in Hawaii, and to a significantly lesser extent, California, and (ii) the composition of our loan portfolio. Loan demand, deposit growth, Provision, asset quality, noninterest income and noninterest expense are all affected by changes in economic conditions. If the residential and commercial real estate markets we have exposure to deteriorate as they did in the latter part of 2007 through 2010, our results of operations would be negatively impacted.

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## Results of Operations

## Net Interest Income

Net interest income, when annualized and expressed as a percentage of average interest earning assets, is referred to as "net interest margin." Interest income, which includes loan fees and resultant yield information, is expressed on a taxable equivalent basis using an assumed income tax rate of 35%. A comparison of net interest income on a taxable equivalent basis ("net interest income") for the three and six months ended June 30, 2017 and 2016 is set forth below.

| (dollars in thousands)                                      | Three Months Ended June 30,<br>2017 |                                    |                                | 2016               |                                    |                      | Variance           |                           |                                |
|---|-------------------------------------|------------------------------------|--------------------------------|--------------------|------------------------------------|----------------------|--------------------|---------------------------|--------------------------------|
|   | Average<br>Balance                  | Average Interest<br>Yield/<br>Rate | Interest<br>Income/<br>Expense | Average<br>Balance | Average Interest<br>Yield/<br>Rate | Interest/<br>Expense | Average<br>Balance | Average<br>Yield/<br>Rate | Interest<br>Income/<br>Expense |
| <b>Assets</b>   |                                     |                                    |                                |                    |                                    |                      |                    |                           |                                |
| <b>Interest earning assets:</b>                             |                                     |                                    |                                |                    |                                    |                      |                    |                           |                                |
| Interest-bearing deposits<br>in other banks                 | \$22,840                            | 1.07 %                             | 61                             | \$8,946            | 0.48 %                             | 11                   | \$13,894           | 0.59 %                    | 50                             |
| Investment securities,<br>excluding valuation<br>allowance: |                                     |                                    |                                |                    |                                    |                      |                    |                           |                                |
| Taxable (1)   | 1,344,467                           | 2.53                               | 8,493                          | 1,318,579          | 2.42                               | 7,963                | 25,888             | 0.11                      | 530                            |
| Tax-exempt (1)  | 170,169                             | 3.52                               | 1,499                          | 173,396            | 3.53                               | 1,530                | (3,227 )           | (0.01)                    | (31 )                          |
| Total investment<br>securities                              | 1,514,636                           | 2.64                               | 9,992                          | 1,491,975          | 2.55                               | 9,493                | 22,661             | 0.09                      | 499                            |
| Loans and leases,<br>including loans held for<br>sale (2)   | 3,593,347                           | 3.96                               | 35,531                         | 3,377,362          | 3.91                               | 32,878               | 215,985            | 0.05                      | 2,653                          |
| Federal Home Loan Bank<br>stock                             | 7,215                               | 1.17                               | 21                             | 12,115             | 0.76                               | 23                   | (4,900 )           | 0.41                      | (2 )                           |
| Total interest earning<br>assets                            | 5,138,038                           | 3.55                               | 45,605                         | 4,890,398          | 3.48                               | 42,405               | 247,640            | 0.07                      | 3,200                          |
| Noninterest-earning assets                                  | 329,423                             |                                    |                                | 357,690            |                                    |                      | (28,267 )          |                           |                                |
| Total assets  | \$5,467,461                         |                                    |                                | \$5,248,088        |                                    |                      | \$219,373          |                           |                                |
| <b>Liabilities and Equity</b>                               |                                     |                                    |                                |                    |                                    |                      |                    |                           |                                |
| <b>Interest-bearing liabilities:</b>                        |                                     |                                    |                                |                    |                                    |                      |                    |                           |                                |
| Interest-bearing demand<br>deposits                         | \$890,827                           | 0.07 %                             | 154                            | \$843,611          | 0.06 %                             | 123                  | \$47,216           | 0.01 %                    | 31                             |
| Savings and money<br>market deposits                        | 1,426,092                           | 0.07                               | 259                            | 1,435,754          | 0.08                               | 269                  | (9,662 )           | (0.01)                    | (10 )                          |
| Time deposits under<br>\$100,000                            | 191,833                             | 0.39                               | 188                            | 207,371            | 0.38                               | 195                  | (15,538 )          | 0.01                      | (7 )                           |
| Time deposits \$100,000<br>and over                         | 981,174                             | 0.80                               | 1,948                          | 837,619            | 0.37                               | 762                  | 143,555            | 0.43                      | 1,186                          |
| Total interest-bearing<br>deposits                          | 3,489,926                           | 0.29                               | 2,549                          | 3,324,355          | 0.16                               | 1,349                | 165,571            | 0.13                      | 1,200                          |
| Short-term borrowings                                       | 18,050                              | 1.03                               | 46                             | 148,390            | 0.48                               | 177                  | (130,340 )         | 0.55                      | (131 )                         |
| Long-term debt  | 92,785                              | 3.70                               | 856                            | 92,785             | 3.19                               | 735                  | —                  | 0.51                      | 121                            |

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|                                    |             |      |       |             |      |       |           |      |       |
|------------------------------------|-------------|------|-------|-------------|------|-------|-----------|------|-------|
| Total interest-bearing liabilities | 3,600,761   | 0.38 | 3,451 | 3,565,530   | 0.26 | 2,261 | 35,231    | 0.12 | 1,190 |
| Noninterest-bearing deposits       | 1,310,889   |      |       | 1,134,664   |      |       | 176,225   |      |       |
| Other liabilities                  | 39,812      |      |       | 37,127      |      |       | 2,685     |      |       |
| Total liabilities                  | 4,951,462   |      |       | 4,737,321   |      |       | 214,141   |      |       |
| Shareholders' equity               | 515,974     |      |       | 510,753     |      |       | 5,221     |      |       |
| Non-controlling interest           | 25          |      |       | 14          |      |       | 11        |      |       |
| Total equity                       | 515,999     |      |       | 510,767     |      |       | 5,232     |      |       |
| Total liabilities and equity       | \$5,467,461 |      |       | \$5,248,088 |      |       | \$219,373 |      |       |

|                     |  |  |          |  |  |  |          |  |         |
|---------------------|--|--|----------|--|--|--|----------|--|---------|
| Net interest income |  |  | \$42,154 |  |  |  | \$40,144 |  | \$2,010 |
|---------------------|--|--|----------|--|--|--|----------|--|---------|

|                      |  |        |  |  |        |  |  |         |  |
|----------------------|--|--------|--|--|--------|--|--|---------|--|
| Interest rate spread |  | 3.17 % |  |  | 3.22 % |  |  | (0.05)% |  |
|----------------------|--|--------|--|--|--------|--|--|---------|--|

|                     |  |        |  |  |        |  |  |     |  |
|---------------------|--|--------|--|--|--------|--|--|-----|--|
| Net interest margin |  | 3.29 % |  |  | 3.29 % |  |  | — % |  |
|---------------------|--|--------|--|--|--------|--|--|-----|--|

(1) At amortized cost.

(2) Includes nonaccrual loans.

Net interest income (expressed on a taxable-equivalent basis) was \$42.2 million for the second quarter of 2017, representing an increase of 5.0% from \$40.1 million in the second quarter of 2016. The increase was primarily attributable to a significant increase in average loans and leases balances funded by growth in lower cost deposits. Offsetting this increase was a significant increase in average time deposits \$100,000 and over, combined with a 43 basis point ("bp") increase in rates paid on time deposits \$100,000 and over.

Average yields earned on our interest-earning assets during the second quarter of 2017 increased by 7 bp from the second quarter of 2016. Average rates paid on our interest-bearing liabilities increased by 12 bp in the second quarter of 2017 compared to the second quarter of 2016.

In the second quarter of 2017, we completed an investment portfolio repositioning strategy designed to enhance potential prospective earnings and improve net interest margin. In connection with the repositioning, we sold \$97.7 million in lower-yielding available-for-sale investment securities, and purchased \$97.4 million in higher yielding, longer duration investment securities. The securities sold had a duration of 3.3 and an average yield of 1.91%. Gross proceeds from the sale were immediately reinvested back into securities with a duration of 4.6 and an average yield of 2.57%. The new securities were classified in the available-for-sale portfolio. Gross realized losses on the sale of the securities were \$1.6 million, recorded in other operating income.

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|   | Six Months Ended June 30,<br>2017 |                                    |                                | 2016               |                                    |                                | Variance           |                           |                                |
|---|-----------------------------------|------------------------------------|--------------------------------|--------------------|------------------------------------|--------------------------------|--------------------|---------------------------|--------------------------------|
|   | Average<br>Balance                | Average Interest<br>Yield/<br>Rate | Interest<br>Income/<br>Expense | Average<br>Balance | Average Interest<br>Yield/<br>Rate | Interest<br>Income/<br>Expense | Average<br>Balance | Average<br>Yield/<br>Rate | Interest<br>Income/<br>Expense |
| <b>Assets</b>   |                                   |                                    |                                |                    |                                    |                                |                    |                           |                                |
| <b>Interest earning assets:</b>                             |                                   |                                    |                                |                    |                                    |                                |                    |                           |                                |
| Interest-bearing deposits<br>in other banks                 | \$31,328                          | 0.87 %                             | 135                            | \$11,468           | 0.48 %                             | 28                             | \$19,860           | 0.39 %                    | 107                            |
| Investment securities,<br>excluding valuation<br>allowance: |                                   |                                    |                                |                    |                                    |                                |                    |                           |                                |
| Taxable investment<br>securities (1)                        | 1,337,232                         | 2.49                               | 16,640                         | 1,325,148          | 2.47                               | 16,369                         | 12,084             | 0.02                      | 271                            |
| Tax-exempt investment<br>securities (1)                     | 170,651                           | 3.52                               | 3,005                          | 173,720            | 3.53                               | 3,063                          | (3,069 )           | (0.01)                    | (58 )                          |
| Total investment<br>securities                              | 1,507,883                         | 2.61                               | 19,645                         | 1,498,868          | 2.59                               | 19,432                         | 9,015              | 0.02                      | 213                            |
| Loans and leases,<br>including loans held for<br>sale (2)   | 3,570,658                         | 3.97                               | 70,488                         | 3,318,117          | 3.91                               | 64,671                         | 252,541            | 0.06                      | 5,817                          |
| Federal Home Loan Bank<br>stock                             | 6,995                             | 2.20                               | 77                             | 9,874              | 1.21                               | 60                             | (2,879 )           | 0.99                      | 17                             |
| Total interest earning<br>assets                            | 5,116,864                         | 3.55                               | 90,345                         | 4,838,327          | 3.49                               | 84,191                         | 278,537            | 0.06                      | 6,154                          |
| Noninterest-earning assets                                  | 328,255                           |                                    |                                | 360,089            |                                    |                                | (31,834 )          |                           |                                |
| Total assets  | \$5,445,119                       |                                    |                                | \$5,198,416        |                                    |                                | \$246,703          |                           |                                |
| <b>Liabilities and Equity</b>                               |                                   |                                    |                                |                    |                                    |                                |                    |                           |                                |
| <b>Interest-bearing liabilities:</b>                        |                                   |                                    |                                |                    |                                    |                                |                    |                           |                                |
| Interest-bearing demand<br>deposits                         | \$885,159                         | 0.07 %                             | 294                            | \$835,556          | 0.06 %                             | 234                            | \$49,603           | 0.01 %                    | 60                             |
| Savings and money<br>market deposits                        | 1,422,775                         | 0.07                               | 516                            | 1,431,743          | 0.07                               | 532                            | (8,968 )           | —                         | (16 )                          |
| Time deposits under<br>\$100,000                            | 192,730                           | 0.39                               | 368                            | 209,497            | 0.38                               | 392                            | (16,767 )          | 0.01                      | (24 )                          |
| Time deposits \$100,000<br>and over                         | 1,003,553                         | 0.70                               | 3,485                          | 863,151            | 0.34                               | 1,463                          | 140,402            | 0.36                      | 2,022                          |
| Total interest-bearing<br>deposits                          | 3,504,217                         | 0.27                               | 4,663                          | 3,339,947          | 0.16                               | 2,621                          | 164,270            | 0.11                      | 2,042                          |
| Short-term borrowings                                       | 16,423                            | 0.94                               | 77                             | 96,407             | 0.47                               | 227                            | (79,984 )          | 0.47                      | (150 )                         |
| Long-term debt  | 92,785                            | 3.63                               | 1,669                          | 92,785             | 3.14                               | 1,451                          | —                  | 0.49                      | 218                            |
| Total interest-bearing<br>liabilities                       | 3,613,425                         | 0.36                               | 6,409                          | 3,529,139          | 0.24                               | 4,299                          | 84,286             | 0.12                      | 2,110                          |
| Noninterest-bearing<br>deposits                             | 1,277,733                         |                                    |                                | 1,123,597          |                                    |                                | 154,136            |                           |                                |
| Other liabilities   | 40,533                            |                                    |                                | 37,620             |                                    |                                | 2,913              |                           |                                |
| Total liabilities   | 4,931,691                         |                                    |                                | 4,690,356          |                                    |                                | 241,335            |                           |                                |
| Shareholders' equity  | 513,403                           |                                    |                                | 508,041            |                                    |                                | 5,362              |                           |                                |

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|                              |             |             |           |
|------------------------------|-------------|-------------|-----------|
| Non-controlling interest     | 25          | 19          | 6         |
| Total equity                 | 513,428     | 508,060     | 5,368     |
| Total liabilities and equity | \$5,445,119 | \$5,198,416 | \$246,703 |

|                      |        |          |          |         |
|----------------------|--------|----------|----------|---------|
| Net interest income  |        | \$83,936 | \$79,892 | \$4,044 |
| Interest rate spread | 3.19 % |          | 3.25 %   | (0.06)% |
| Net interest margin  | 3.29 % |          | 3.31 %   | (0.02)% |

(1) At amortized cost.

(2) Includes nonaccrual loans.

Net interest income (expressed on a taxable-equivalent basis) was \$83.9 million for the six months ended June 30, 2017, representing an increase of 5.1% from \$79.9 million in the six months ended June 30, 2016. The increase was primarily attributable to a significant increase in average loans and leases balances funded by growth in lower cost deposits, combined with a 6 bp increase in average yields earned on loans and leases. Offsetting this increase was a significant increase in average time deposits \$100,000 and over, combined with a 36 bp increase in rates paid on time deposits \$100,000 and over.



Average yields earned on our interest-earning assets during the six months ended June 30, 2017 increased by 6 bp from the six months ended June 30, 2016. Average rates paid on our interest-bearing liabilities increased by 12 bp in the six months ended June 30, 2017 compared to the six months ended June 30, 2016.

#### Interest Income

Taxable-equivalent interest income was \$45.6 million for the second quarter of 2017, representing an increase of 7.5% from \$42.4 million in the second quarter of 2016. The increase was primarily attributable to a \$216.0 million increase in average loans and leases compared to the second quarter of 2016, accounting for approximately \$2.2 million of the increase in interest income during the second quarter of 2017. In addition, average yields earned on loans and leases during the second quarter of 2017 increased by 5 bp compared to the second quarter of 2016. The increase was primarily attributable to \$0.4 million in net loan interest recoveries received during the second quarter of 2017. Average yields earned on investment securities compared to the second quarter of 2016 also increased by 9 bp, increasing interest income by approximately \$0.4 million.

Taxable-equivalent interest income was \$90.3 million for the six months ended June 30, 2017, representing an increase of 7.3% from \$84.2 million in the six months ended June 30, 2016. The increase was primarily attributable to a \$252.5 million increase in average loans and leases compared to the six months ended June 30, 2016, accounting for approximately \$4.8 million of the increase in interest income during the six months ended June 30, 2017. In addition, average yields earned on loans and leases during the six months ended June 30, 2017 increased by 6 bp compared to the six months ended June 30, 2016. The increase was primarily attributable to \$1.4 million in net loan interest recoveries received during the six months ended June 30, 2017.

#### Interest Expense

Interest expense for the second quarter of 2017 was \$3.5 million, representing an increase of 52.6% from the second quarter of 2016. The increase was primarily attributable to a \$140.4 million increase in average time deposits \$100,000 and over, combined with a 43 bp increase in average rates paid on time deposits \$100,000 and over, which increased interest expense by \$1.1 million.

Interest expense for the six months ended June 30, 2017 was \$6.4 million, representing an increase of 49.1% from the six months ended June 30, 2016. The increase was primarily attributable to a \$140.4 million increase in average time deposits \$100,000 and over, combined with a 36 bp increase in average rates paid on time deposits \$100,000 and over, which increased interest expense by \$1.8 million.

#### Net Interest Margin

Our net interest margin of 3.29% for the second quarter of 2017 remained unchanged from the second quarter of 2016. Increases in the average yields earned on our investment securities and loans and leases portfolios were offset by the increases in the average rates paid on our time deposits \$100,000 and over.

Our net interest margin was 3.29% for the six months ended June 30, 2017, compared to 3.31% for the six months ended June 30, 2016. The decrease in our net interest margin was primarily attributable to a 36 bp increase in average rates paid on our time deposits \$100,000 and over, partially offset by a 6 bp increase in average yields earned on our loans and leases portfolio.

The historically low interest rate environment that we continue to operate in is the result of the target Federal Funds range of 0% to 0.25% initially set by the Federal Reserve in the fourth quarter of 2008 and other economic policies implemented by the FRB, which continued through the third quarter of 2015. In December 2015, the Federal Reserve

increased the target Federal Funds range to 0.25% to 0.50% based on the improvement in labor market conditions and positive economic outlook. Citing improvement in labor market conditions, a move toward more stable prices, and a positive economic outlook, the Federal Reserve increased the target Federal Funds range to 0.50% to 0.75% in December 2016. In 2017, the Federal Reserve has increased the Federal Funds range twice to 0.75% to 1.00% in March 2017 and 1.00% to 1.25% in June 2017. Furthermore, the Federal Reserve announced their intent to remove monetary policy accommodation through the gradual unwind of their balance sheet that was grown following the recession through their quantitative easing programs.

We do not expect the target Federal Funds range to change during the remainder of 2017 as the outlook for inflation has slowed due to uncertainty around fiscal policy as well as expectations that the Federal Reserves near term monetary policy tightening preference may shift towards unwinding their balance sheet rather than further rate hikes.

## Provision for Loan and Lease Losses

Our Provision was a credit of \$2.3 million during the second quarter of 2017, compared to a credit of \$1.4 million in the second quarter of 2016. Our net charge-offs were \$0.3 million during the second quarter of 2017, compared to net charge-offs of \$3 thousand in the second quarter of 2016.

Our Provision was a credit of \$2.4 million during the six months ended June 30, 2017, compared to a credit of \$2.1 million in the six months ended June 30, 2016. Our net charge-offs were \$1.4 million during the six months ended June 30, 2017, compared to net charge-offs of \$0.4 million in the six months ended June 30, 2016.

The credit to the provision for loan and lease losses in the three and six months ended June 30, 2017 was primarily attributable to continued implementation of the enhanced Allowance methodology from the fourth quarter of 2016 as well as an increase in recoveries in the second quarter of 2017 and continued improvement in portfolio credit quality. Nonperforming assets of \$9.0 million as of June 30, 2017 decreased by \$0.1 million from December 31, 2016.

## Other Operating Income

The following tables set forth components of other operating income for the periods indicated:

| (dollars in thousands)                                      | Three Months Ended |               |           |          |
|---|--------------------|---------------|-----------|----------|
|   | June 30, 2017      | June 30, 2016 | \$ Change | % Change |
| Mortgage banking income                                     | \$1,957            | \$1,423       | \$534     | 37.5 %   |
| Service charges on deposit accounts                         | 2,120              | 1,908         | 212       | 11.1 %   |
| Other service charges and fees                              | 3,053              | 3,028         | 25        | 0.8 %    |
| Income from fiduciary activities                            | 964                | 857           | 107       | 12.5 %   |
| Equity in earnings of unconsolidated subsidiaries           | 151                | 184           | (33)      | -17.9 %  |
| Fees on foreign exchange                                    | 130                | 126           | 4         | 3.2 %    |
| Investment securities gains (losses)                        | (1,640)            | —             | (1,640)   | N.M.     |
| Income from bank-owned life insurance                       | 583                | 1,232         | (649)     | -52.7 %  |
| Loan placement fees   | 146                | 133           | 13        | 9.8 %    |
| Net gain on sales of foreclosed assets                      | 84                 | 241           | (157)     | -65.1 %  |
| Other:  |                    |               |           |          |
| Income recovered on nonaccrual loans previously charged-off | 25                 | 301           | (276)     | -91.7 %  |
| Other recoveries  | 54                 | 249           | (195)     | -78.3 %  |
| Commissions on sale of checks                               | 85                 | 86            | (1)       | -1.2 %   |
| Other   | 158                | 169           | (11)      | -6.5 %   |
| Total other operating income                                | \$7,870            | \$9,937       | \$(2,067) | -20.8 %  |

For the second quarter of 2017, total other operating income of \$7.9 million decreased by \$2.1 million, or 20.8%, from \$9.9 million in the year-ago quarter. The decrease from the comparable prior year period was primarily due to the investment securities loss of \$1.6 million related to the aforementioned investment securities portfolio repositioning, combined with lower income from bank-owned life insurance of \$0.6 million and lower income recovered on nonaccrual loans previously charged-off of \$0.3 million. The lower income from bank-owned life insurance was primarily attributable to death benefit income of \$0.6 million recorded in the year-ago quarter. These negative variances were partially offset by higher mortgage banking income of \$0.5 million. The higher mortgage banking income was primarily attributable to lower amortization of mortgage servicing rights of \$1.2 million due to slower prepayment activity, partially offset by lower net gains on sales of residential mortgage loans of \$0.8 million.



| (dollars in thousands)                                      | Six Months Ended |               |           |          |
|---|------------------|---------------|-----------|----------|
|   | June 30, 2017    | June 30, 2016 | \$ Change | % Change |
| Mortgage banking income                                     | \$3,900          | \$2,663       | \$1,237   | 46.5 %   |
| Service charges on deposit accounts                         | 4,156            | 3,872         | 284       | 7.3 %    |
| Other service charges and fees                              | 5,801            | 5,795         | 6         | 0.1 %    |
| Income from fiduciary activities                            | 1,828            | 1,697         | 131       | 7.7 %    |
| Equity in earnings of unconsolidated subsidiaries           | 212              | 274           | (62 )     | -22.6 %  |
| Fees on foreign exchange                                    | 293              | 274           | 19        | 6.9 %    |
| Investment securities gains (losses)                        | (1,640 )         | —             | (1,640 )  | N.M.     |
| Income from bank-owned life insurance                       | 1,700            | 1,857         | (157 )    | -8.5 %   |
| Loan placement fees   | 280              | 179           | 101       | 56.4 %   |
| Net gain on sales of foreclosed assets                      | 186              | 549           | (363 )    | -66.1 %  |
| Other:  |                  |               |           |          |
| Income recovered on nonaccrual loans previously charged-off | 586              | 458           | 128       | 27.9 %   |
| Other recoveries  | 91               | 270           | (179 )    | -66.3 %  |
| Commissions on sale of checks                               | 172              | 172           | —         | — %      |
| Other   | 319              | 533           | (214 )    | -40.2 %  |
| Total other operating income                                | \$17,884         | \$18,593      | \$(709 )  | -3.8 %   |

For the six months ended June 30, 2017, total other operating income of \$17.9 million decreased by \$0.7 million, or 3.8%, from \$18.6 million in the comparable prior year period. The decrease from the comparable prior year period was primarily due to the aforementioned investment securities loss of \$1.6 million, combined with lower net gain on sales of foreclosed assets of \$0.4 million. These negative variances were partially offset by higher mortgage banking income of \$1.2 million. The higher mortgage banking income was primarily attributable to lower amortization of mortgage servicing rights of \$2.2 million due to slower prepayment activity, partially offset by lower net gains on sales of residential mortgage loans of \$0.9 million.

## Other Operating Expense

The following tables set forth components of other operating expense for the periods indicated:

| (dollars in thousands)  | Three Months Ended |               |           |          |
|---|--------------------|---------------|-----------|----------|
|   | June 30, 2017      | June 30, 2016 | \$ Change | % Change |
| Salaries and employee benefits  | \$17,983           | \$17,850      | \$133     | 0.7 %    |
| Net occupancy   | 3,335              | 3,557         | (222)     | -6.2 %   |
| Equipment   | 967                | 769           | 198       | 25.7 %   |
| Amortization of core deposit premium                                      | 669                | 668           | 1         | 0.1 %    |
| Communication expense   | 891                | 919           | (28)      | -3.0 %   |
| Legal and professional services   | 1,987              | 1,723         | 264       | 15.3 %   |
| Computer software expense   | 2,190              | 2,222         | (32)      | -1.4 %   |
| Advertising expense   | 390                | 433           | (43)      | -9.9 %   |
| Foreclosed asset expense  | 63                 | 49            | 14        | 28.6 %   |
| Other:  |                    |               |           |          |
| Charitable contributions  | 136                | 184           | (48)      | -26.1 %  |
| FDIC insurance assessment   | 429                | 563           | (134)     | -23.8 %  |
| Miscellaneous loan expenses   | 293                | 306           | (13)      | -4.2 %   |
| ATM and debit card expenses   | 468                | 448           | 20        | 4.5 %    |
| Amortization of investments in low-income housing tax credit partnerships | 223                | 258           | (35)      | -13.6 %  |
| Armored car expenses  | 198                | 201           | (3)       | -1.5 %   |
| Entertainment and promotions  | 246                | 223           | 23        | 10.3 %   |
| Stationery and supplies   | 230                | 172           | 58        | 33.7 %   |
| Directors' fees and expenses  | 250                | 199           | 51        | 25.6 %   |
| Provision (credit) for residential mortgage loan repurchase losses        | —                  | (36)          | 36        | -100.0 % |
| Increase (decrease) to the reserve for unfunded commitments               | 53                 | 20            | 33        | 165.0 %  |
| Other   | 1,334              | 1,732         | (398)     | -23.0 %  |
| Total other operating expense   | \$32,335           | \$32,460      | \$(125)   | -0.4 %   |

For the second quarter of 2017, total other operating expense was \$32.3 million and decreased by \$0.1 million, or 0.4%, from \$32.5 million in the year-ago quarter. Increases in legal and professional services of \$0.3 million, equipment expense of \$0.2 million, and salaries and employee benefits of \$0.1 million were partially offset by decreases in net occupancy expense of \$0.2 million and FDIC insurance assessment of \$0.1 million.

| (dollars in thousands)  | Six Months Ended |               |           |          |
|---|------------------|---------------|-----------|----------|
|   | June 30, 2017    | June 30, 2016 | \$ Change | % Change |
| Salaries and employee benefits  | \$35,370         | \$34,787      | \$ 583    | 1.7 %    |
| Net occupancy   | 6,749            | 6,871         | (122 )    | -1.8 %   |
| Equipment   | 1,809            | 1,580         | 229       | 14.5 %   |
| Amortization of core deposit premium                                      | 1,337            | 1,337         | —         | — %      |
| Communication expense   | 1,791            | 1,878         | (87 )     | -4.6 %   |
| Legal and professional services   | 3,779            | 3,336         | 443       | 13.3 %   |
| Computer software expense   | 4,442            | 4,926         | (484 )    | -9.8 %   |
| Advertising expense   | 782              | 1,067         | (285 )    | -26.7 %  |
| Foreclosed asset expense  | 99               | 64            | 35        | 54.7 %   |
| Other:  |                  |               |           |          |
| Charitable contributions  | 287              | 402           | (115 )    | -28.6 %  |
| FDIC insurance assessment   | 853              | 1,202         | (349 )    | -29.0 %  |
| Miscellaneous loan expenses   | 554              | 560           | (6 )      | -1.1 %   |
| ATM and debit card expenses   | 918              | 876           | 42        | 4.8 %    |
| Amortization of investments in low-income housing tax credit partnerships | 456              | 515           | (59 )     | -11.5 %  |
| Armored car expenses  | 456              | 402           | 54        | 13.4 %   |
| Entertainment and promotions  | 404              | 454           | (50 )     | -11.0 %  |
| Stationery and supplies   | 408              | 439           | (31 )     | -7.1 %   |
| Directors' fees and expenses  | 457              | 404           | 53        | 13.1 %   |
| Provision (credit) for residential mortgage loan repurchase losses        | —                | (387 )        | 387       | -100.0 % |
| Increase (decrease) to the reserve for unfunded commitments               | 123              | 64            | 59        | 92.2 %   |
| Other   | 2,721            | 3,049         | (328 )    | -10.8 %  |
| Total other operating expense   | \$63,795         | \$63,826      | \$ (31 )  | — %      |

For the six months ended June 30, 2017, total other operating expense was \$63.8 million and remained relatively unchanged from the comparable prior year period. Decreases in computer software expense, FDIC insurance assessment, and advertising expense were partially offset by higher salaries and employee benefits and legal and professional services.

A key measure of operating efficiency tracked by management is the efficiency ratio, which is calculated by dividing total operating expenses by total revenue (net interest income and total other operating income). Management believes that the efficiency ratio provides useful supplemental information that is important to a proper understanding of the company's core business results by investors. Our efficiency ratio should not be viewed as a substitute for results determined in accordance with GAAP, nor is it necessarily comparable to the efficiency ratio presented by other companies.

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

| (dollars in thousands)        | Three Months Ended |               | Six Months Ended |               |
|-------------------------------|--------------------|---------------|------------------|---------------|
|                               | June 30, 2017      | June 30, 2016 | June 30, 2017    | June 30, 2016 |
| Total other operating expense | \$32,335           | \$32,460      | \$63,795         | \$63,826      |
| Net interest income           | \$41,629           | \$39,609      | \$82,884         | \$78,820      |
| Total other operating income  | 7,870              | 9,937         | 17,884           | 18,593        |
| Total revenue                 | \$49,499           | \$49,546      | \$100,768        | \$97,413      |

Efficiency ratio                    65.32   % 65.51   % 63.31   % 65.52   %

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Our efficiency ratio of 65.32% in the second quarter of 2017 remained relatively unchanged compared to 65.51% in the year-ago quarter. The improvement in net interest income was offset by the aforementioned investment securities loss related to the investment securities portfolio repositioning. Our efficiency ratio in the six months ended June 30, 2017 improved to 63.31%, compared to 65.52% in the comparable prior year period. The efficiency ratio during the six months ended June 30, 2017 was positively impacted by the growth in net interest income and higher mortgage banking income, partially offset by the aforementioned investment securities loss.

On December 31, 2016, the Company elected to reclassify loan servicing fees, amortization of mortgage servicing rights, net gain on sale of residential mortgage loans, and unrealized gain (loss) on interest rate locks into a single line item called "mortgage banking income" in the Company's consolidated statements of income. Loan servicing fees and net gain on sale of residential mortgage loans were previously recorded in its own line in the other operating income section of the consolidated statements of income, while unrealized gain (loss) on interest rate locks was included as a component of other operating income - other. The amortization of mortgage servicing rights was previously recorded as a component of amortization and impairment of other intangible assets in the other operating expense section of the Company's consolidated statements of income. The components of mortgage banking income are disclosed in Note 12 - Mortgage Banking Income to the consolidated financial statements. The Company believes the reclassification provides a better presentation of revenues and costs of our mortgage banking activities. Comparative financial statements of prior years have been adjusted retrospectively.

#### Income Taxes

For the second quarter of 2017, the Company recorded income tax expense of \$7.4 million compared to \$6.3 million in the same prior year period. The increase in income tax expense in the three and six months ended June 30, 2017 is primarily due to the increase in pre-tax income, combined with \$0.9 million in additional income tax expense related to a former executive's supplemental executive retirement plan ("SERP") benefit payout and adjustment to the deferred tax asset related to SERP.

The effective tax rate for the second quarter of 2017 was 38.16%, compared to 34.28% in the same prior year period. Income tax expense and the effective tax rate in the three and six months ended June 30, 2017 was negatively impacted by the aforementioned \$0.9 million in additional income tax expense. This was partially offset by \$0.5 million and \$0.6 million in excess tax benefits from the vesting of restricted stock units recorded in the three and six months ended June 30, 2017, respectively. Prior to the adoption of ASU 2016-09, excess tax benefits from the vesting of restricted stock units were recorded in shareholders' equity.

The remaining valuation allowance on our net DTA totaled \$2.7 million at June 30, 2017 and \$2.8 million at December 31, 2016, which related to our California state income taxes as we do not expect to generate sufficient income in California to utilize the DTA. Net of this valuation allowance, the Company's net DTA totaled \$41.3 million at June 30, 2017, compared to a net DTA of \$58.9 million as of December 31, 2016, and is included in other assets on our consolidated balance sheets. The decrease in net DTA is primarily due to projected utilization of income tax credit carryforwards.

#### Financial Condition

Total assets at June 30, 2017 of \$5.53 billion increased by \$148.9 million from \$5.38 billion at December 31, 2016. The increase in total assets and total liabilities was primarily due to our deposit growth and deployment of these proceeds into higher yielding assets.

#### Investment Securities

Investment securities of \$1.52 billion at June 30, 2017 increased by \$59.0 million, or 4.0%, from December 31, 2016. The increase reflects investment securities purchases totaling \$253.4 million and a \$8.1 million increase in the market valuation on the available-for-sale portfolio, partially offset by the sale of investment securities totaling \$97.7 million related to the investment securities portfolio repositioning and \$104.9 million in principal runoff.

## Loans and Leases

The following table sets forth information regarding our outstanding loans and leases by category and geographic location as of the dates indicated.

| (Dollars in thousands)                 | June 30,<br>2017 | December 31,<br>2016 | \$ Change  | %<br>Change |
|--|------------------|----------------------|------------|-------------|
| <b>HAWAII:</b>                         |                  |                      |            |             |
| Commercial, financial and agricultural | \$395,512        | \$373,006            | \$22,506   | 6.0 %       |
| Real estate:                           |                  |                      |            |             |
| Construction                           | 91,080           | 97,873               | (6,793 )   | (6.9 )      |
| Residential mortgage                   | 1,249,617        | 1,217,234            | 32,383     | 2.7         |
| Home equity                            | 394,720          | 361,209              | 33,511     | 9.3         |
| Commercial mortgage                    | 767,661          | 767,586              | 75         | —           |
| Consumer:                              |                  |                      |            |             |
| Automobiles                            | 146,223          | 131,037              | 15,186     | 11.6        |
| Other consumer                         | 159,685          | 177,122              | (17,437 )  | (9.8 )      |
| Leases                                 | 523              | 677                  | (154 )     | (22.7)      |
| Total loans and leases                 | 3,205,021        | 3,125,744            | 79,277     | 2.5         |
| Allowance for loan and lease losses    | (47,185 )        | (49,350 )            | 2,165      | (4.4 )      |
| Net loans and leases                   | \$3,157,836      | \$3,076,394          | \$81,442   | 2.6         |
| <b>U.S. MAINLAND:</b>                  |                  |                      |            |             |
| Commercial, financial and agricultural | \$104,380        | \$137,434            | \$(33,054) | (24.1)      |
| Real estate:                           |                  |                      |            |             |
| Construction                           | 2,757            | 3,665                | (908 )     | (24.8)      |
| Residential mortgage                   | —                | —                    | —          | —           |
| Home equity                            | —                | —                    | —          | —           |
| Commercial mortgage                    | 127,351          | 117,853              | 9,498      | 8.1         |
| Consumer:                              |                  |                      |            |             |
| Automobiles                            | 110,635          | 81,889               | 28,746     | 35.1        |
| Other consumer                         | 41,591           | 58,305               | (16,714 )  | (28.7)      |
| Leases                                 | —                | —                    | —          | —           |
| Total loans and leases                 | 386,714          | 399,146              | (12,432 )  | (3.1 )      |
| Allowance for loan and lease losses    | (5,643 )         | (7,281 )             | 1,638      | (22.5)      |
| Net loans and leases                   | \$381,071        | \$391,865            | \$(10,794) | (2.8 )      |
| <b>TOTAL:</b>                          |                  |                      |            |             |
| Commercial, financial and agricultural | \$499,892        | \$510,440            | \$(10,548) | (2.1 )      |
| Real estate:                           |                  |                      |            |             |
| Construction                           | 93,837           | 101,538              | (7,701 )   | (7.6 )      |
| Residential mortgage                   | 1,249,617        | 1,217,234            | 32,383     | 2.7         |
| Home equity                            | 394,720          | 361,209              | 33,511     | 9.3         |
| Commercial mortgage                    | 895,012          | 885,439              | 9,573      | 1.1         |
| Consumer:                              |                  |                      |            |             |
| Automobiles                            | 256,858          | 212,926              | 43,932     | 20.6        |
| Other consumer                         | 201,276          | 235,427              | (34,151 )  | (14.5)      |
| Leases                                 | 523              | 677                  | (154 )     | (22.7)      |
| Total loans and leases                 | 3,591,735        | 3,524,890            | 66,845     | 1.9         |

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|                                     |             |             |          |        |
|-------------------------------------|-------------|-------------|----------|--------|
| Allowance for loan and lease losses | (52,828 )   | (56,631 )   | 3,803    | (6.7 ) |
| Net loans and leases                | \$3,538,907 | \$3,468,259 | \$70,648 | 2.0    |

Loans and leases, net of deferred costs, of \$3.59 billion at June 30, 2017 increased by \$66.8 million, or 1.9%, from December 31, 2016. The increase reflects net increases in the following loan portfolios: automobiles of \$43.9 million, home equity of \$33.5 million, residential mortgage of \$32.4 million, and commercial mortgage of \$9.6 million. These increases were

partially offset by net decreases in the following loan portfolios: other consumer of \$34.2 million, commercial, financial and agricultural of \$10.5 million, and construction of \$7.7 million. The net increase in the loan portfolio also includes loan charge-offs totaling \$3.8 million during the six months ended June 30, 2017.

The Hawaii loan portfolio increased by \$79.3 million, or 2.5%, from December 31, 2016. The increase reflects net increases in the following loan portfolios: home equity of \$33.5 million, residential mortgage of \$32.4 million, commercial, financial and agricultural of \$22.5 million, and automobiles of \$15.2 million. The increases in the real estate portfolios were primarily due to an increased demand from both new and existing customers. This was partially offset by net decreases in the Hawaii other consumer and construction loan portfolios.

The U.S. Mainland loan portfolio decreased by \$12.4 million, or 3.1% from December 31, 2016. The net decrease was primarily attributable to reductions in the commercial, financial, and agricultural and other consumer loan portfolios, partially offset by a net increase in the automobile loan portfolio. In March 2017, we purchased a U.S. Mainland direct auto loan portfolio totaling \$24.1 million which included a \$0.4 million premium over the \$23.8 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 55 months and a weighted average yield, net of the premium paid and servicing costs, of 2.60%. In May 2017, we purchased a U.S. Mainland indirect auto loan portfolio totaling \$26.6 million which included a \$0.9 million premium over the \$25.7 million outstanding balance. At the time of purchase, the auto loans had a weighted average remaining term of 77 months and a weighted average yield, net of the premium paid and servicing costs, of 2.67%.

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

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

| (dollars in thousands)  | June 30,<br>2017 | December 31,<br>2016 | \$<br>Change | %<br>Change |
|---|------------------|----------------------|--------------|-------------|
| <b>Nonperforming Assets</b>   |                  |                      |              |             |
| <b>Nonaccrual loans (including loans held for sale):</b>  |                  |                      |              |             |
| Commercial, financial and agricultural  | \$ 1,000         | \$ 1,877             | \$(877 )     | (46.7 )%    |
| Real estate:  |                  |                      |              |             |
| Residential mortgage  | 4,691            | 5,322                | (631 )       | (11.9 )     |
| Home equity   | 1,509            | 333                  | 1,176        | 353.2       |
| Commercial mortgage   | 834              | 864                  | (30 )        | (3.5 )      |
| Total nonaccrual loans  | 8,034            | 8,396                | (362 )       | (4.3 )      |
| <b>Other real estate owned ("OREO"):</b>  |                  |                      |              |             |
| Real estate:  |                  |                      |              |             |
| Residential mortgage  | 1,008            | 791                  | 217          | 27.4        |
| Total OREO  | 1,008            | 791                  | 217          | 27.4        |
| Total nonperforming assets  | 9,042            | 9,187                | (145 )       | (1.6 )      |
| <b>Accruing Loans Delinquent for 90 Days or More</b>  |                  |                      |              |             |
| Real estate:  |                  |                      |              |             |
| Home equity   | —                | 1,120                | (1,120 )     | (100.0)     |
| Consumer:   |                  |                      |              |             |
| Automobiles   | 130              | 208                  | (78 )        | (37.5 )     |
| Other consumer  | 123              | 63                   | 60           | 95.2        |
| Total accruing loans delinquent for 90 days or more   | 253              | 1,391                | (1,138 )     | (81.8 )     |
| <b>Restructured Loans Still Accruing Interest</b>   |                  |                      |              |             |
| Commercial, financial and agricultural  | 265              | —                    | 265          | —           |
| Real estate:  |                  |                      |              |             |
| Construction  | —                | 21                   | (21 )        | (100.0)     |
| Residential mortgage  | 12,230           | 14,292               | (2,062 )     | (14.4 )     |
| Commercial mortgage   | 1,675            | 1,879                | (204 )       | (10.9 )     |
| Total restructured loans still accruing interest  | 14,170           | 16,192               | (2,022 )     | (12.5 )     |
| Total nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest  | \$ 23,465        | \$ 26,770            | \$(3,305)    | (12.3 )     |
| Ratio of nonaccrual loans to total loans and leases   | 0.22             | % 0.24               | %            | (0.02 )%    |
| Ratio of nonperforming assets to total loans and leases and OREO  | 0.25             | % 0.26               | %            | (0.01 )%    |
| Ratio of nonperforming assets and accruing loans delinquent for 90 days or more to total loans and leases and OREO  | 0.26             | % 0.30               | %            | (0.04 )%    |
| Ratio of nonperforming assets, accruing loans delinquent for 90 days or more, and restructured loans still accruing interest to total loans and leases and OREO | 0.65             | % 0.76               | %            | (0.11 )%    |



The following table sets forth activity in nonperforming assets as of the date indicated.

Year-to-Date Changes in Nonperforming Assets:

(dollars in thousands)

|  |          |
|--|----------|
| Balance at December 31, 2016             | \$9,187  |
| Additions                                | 3,411    |
| Reductions:                              |          |
| Payments                                 | (953 )   |
| Return to accrual status                 | (2,696 ) |
| Charge-offs and/or valuation adjustments | 93       |
| Total reductions                         | (3,556 ) |
| Net increase (decrease)                  | (145 )   |
| Balance at June 30, 2017                 | \$9,042  |

Nonperforming assets, which includes nonaccrual loans and leases and other real estate, totaled \$9.0 million at June 30, 2017, compared to \$9.2 million at December 31, 2016. There were no nonperforming loans classified as held for sale at June 30, 2017 and December 31, 2016. The decrease in nonperforming assets from December 31, 2016 was attributable to \$1.0 million in repayments and \$2.7 million in loans restored to accrual status, offset by additions of \$3.4 million.

Net changes to nonperforming assets by category included net decreases in Hawaii commercial, financial and agricultural assets of \$0.9 million and Hawaii residential mortgage assets of \$0.4 million, partially offset by a net increase in Hawaii home equity assets of \$1.2 million.

Troubled debt restructurings ("TDRs") included in nonperforming assets at June 30, 2017 totaled \$3.8 million and consisted of 12 Hawaii residential mortgage loans with a combined principal balance of \$2.8 million and two Hawaii commercial, financial and agricultural loans with a combined principal balance of \$1.0 million.

Concessions made to the original contractual terms of these loans consisted primarily of the deferral of interest and/or principal payments due to deterioration in the borrowers' financial condition. The principal balances on these TDRs had matured and/or were in default at the time of restructure and we have no commitments to lend additional funds to any of these borrowers. There were \$14.2 million of TDRs still accruing interest at June 30, 2017, none of which were more than 90 days delinquent. At December 31, 2016, there were \$16.2 million of TDRs still accruing interest, none of which were more than 90 days delinquent.



## Allowance for Loan and Lease Losses

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

| (dollars in thousands)   | Three Months Ended |          | Six Months Ended |          |   |
|--|--------------------|----------|------------------|----------|---|
|  | June 30,<br>2017   | 2016     | June 30,<br>2017 | 2016     |   |
| Allowance for Loan and Lease Losses:   |                    |          |                  |          |   |
| Balance at beginning of period   | \$55,369           | \$62,149 | \$56,631         | \$63,314 |   |
| Provision (credit) for loan and lease losses                                 | (2,282 )           | (1,382 ) | (2,362 )         | (2,129 ) |   |
| Charge-offs:   |                    |          |                  |          |   |
| Commercial, financial and agricultural                                       | 337                | 272      | 837              | 624      |   |
| Consumer:  |                    |          |                  |          |   |
| Automobiles  | 352                | 392      | 872              | 773      |   |
| Other consumer   | 1,118              | 743      | 2,095            | 1,474    |   |
| Leases   | —                  | —        | —                | —        |   |
| Total charge-offs  | 1,807              | 1,407    | 3,804            | 2,871    |   |
| Recoveries:  |                    |          |                  |          |   |
| Commercial, financial and agricultural                                       | 236                | 720      | 511              | 1,069    |   |
| Real estate:   |                    |          |                  |          |   |
| Construction   | 56                 | 9        | 77               | 18       |   |
| Residential mortgage   | 637                | 173      | 733              | 207      |   |
| Home equity  | 27                 | 4        | 29               | 7        |   |
| Commercial mortgage  | 128                | 14       | 139              | 27       |   |
| Consumer:  |                    |          |                  |          |   |
| Automobiles  | 284                | 365      | 478              | 559      |   |
| Other consumer   | 180                | 119      | 396              | 563      |   |
| Total recoveries   | 1,548              | 1,404    | 2,363            | 2,450    |   |
| Net charge-offs (recoveries)   | 259                | 3        | 1,441            | 421      |   |
| Balance at end of period   | \$52,828           | \$60,764 | \$52,828         | \$60,764 |   |
| Allowance as a percentage of total loans and leases                          | 1.47               | % 1.79   | % 1.47           | % 1.79   | % |
| Annualized ratio of net charge-offs (recoveries) to average loans and leases | 0.03               | % —      | % 0.08           | % 0.03   | % |

Our Allowance at June 30, 2017 totaled \$52.8 million compared to \$56.6 million at December 31, 2016. The decrease in our Allowance during the six months ended June 30, 2017, was a direct result of \$1.4 million in net charge-offs and a credit to the Provision of \$2.4 million.

Our Allowance as a percentage of total loans and leases decreased from 1.61% at December 31, 2016 to 1.47% at June 30, 2017. Our Allowance as a percentage of nonperforming assets decreased from 616.43% at December 31, 2016 to 584.25% at June 30, 2017.

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

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## Federal Home Loan Bank Stock

The bank is a member of the Federal Home Loan Bank of Des Moines (the "FHLB"). FHLB membership stock of \$6.5 million at June 30, 2017 decreased by \$5.1 million, or 43.9%, from the FHLB membership stock balance at December 31, 2016. FHLB membership stock has an activity-based stock requirement, thus as borrowings decline, so will the FHLB membership stock balance.

## Deposits

The following table sets forth the composition of our deposits by category for the periods indicated:

| (dollars in thousands)                    | June 30,<br>2017 | December<br>31, 2016 | \$ Change  | %<br>Change |
|---|------------------|----------------------|------------|-------------|
| Noninterest-bearing demand deposits       | \$ 1,383,754     | \$ 1,265,246         | \$ 118,508 | 9.4 %       |
| Interest-bearing demand deposits          | 917,956          | 862,991              | 54,965     | 6.4         |
| Savings and money market deposits         | 1,453,108        | 1,390,600            | 62,508     | 4.5         |
| Time deposits less than \$100,000         | 188,782          | 194,730              | (5,948)    | (3.1)       |
| Core deposits                             | 3,943,600        | 3,713,567            | 230,033    | 6.2         |
| Government time deposits                  | 700,284          | 701,417              | (1,133)    | (0.2)       |
| Other time deposits \$100,000 and greater | 242,498          | 193,217              | 49,281     | 25.5        |
| Total time deposits \$100,000 and greater | 942,782          | 894,634              | 48,148     | 5.4         |
| Total deposits                            | \$ 4,886,382     | \$ 4,608,201         | \$ 278,181 | 6.0         |

Total deposits of \$4.89 billion at June 30, 2017 reflected an increase of \$278.2 million, or 6.0%, from total deposits of \$4.61 billion at December 31, 2016. The increase was attributable to net increases in noninterest-bearing demand deposits of \$118.5 million, savings and money market deposits of \$62.5 million, interest-bearing demand deposits of \$55.0 million, and other time deposits \$100,000 and greater of \$49.3 million. These increases were offset by net decreases in time deposits less than \$100,000 of \$5.9 million and government time deposits of \$1.1 million.

Core deposits, which we define as demand deposits, savings and money market deposits, and time deposits less than \$100,000, totaled \$3.94 billion at June 30, 2017 and increased by \$230.0 million, or 6.2%, from December 31, 2016.

## Capital Resources

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

## Common and Preferred Equity

Shareholders' equity totaled \$512.9 million at June 30, 2017, compared to \$504.7 million at December 31, 2016. The increase in total shareholders' equity was attributable to net income of \$25.1 million and other comprehensive income of \$4.7 million in the six months ended June 30, 2017, partially offset by the repurchase of 362,371 shares of common stock under our repurchase program, at a cost of \$11.2 million, and cash dividends paid of \$10.4 million. During the six months ended June 30, 2017, we repurchased approximately 1.2% of our common stock outstanding as of

December 31, 2016.

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

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

| (dollars in thousands)                               | June 30, 2017 | December 31,<br>2016 |
|--|---------------|----------------------|
| Total shareholders' equity                           | \$512,930     | \$504,650            |
| Less: preferred stock                                | —             | —                    |
| Total common equity                                  | 512,930       | 504,650              |
| Less: other intangible assets (core deposit premium) | (3,343 )      | (4,680 )             |
| Tangible common equity                               | \$509,587     | \$499,970            |
| <br>   |               |                      |
| Total assets   | \$5,533,135   | \$5,384,236          |
| Less: other intangible assets (core deposit premium) | (3,343 )      | (4,680 )             |
| Tangible assets                                      | \$5,529,792   | \$5,379,556          |
| <br>   |               |                      |
| Tangible common equity ratio                         | 9.22          | % 9.29 %             |

Our tangible common equity ratio was 9.22% at June 30, 2017, compared to 9.29% at December 31, 2016. Our book value per share was \$16.81 and \$16.39 at June 30, 2017 and December 31, 2016, respectively. Our tangible book value per share was \$16.70 and \$16.23 at June 30, 2017 and December 31, 2016, respectively.

#### Holding Company Capital Resources

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

CPF relies on the bank to pay dividends to it to fund its obligations. As of June 30, 2017, on a stand-alone basis, CPF had an available cash balance of approximately \$19.1 million in order to meet its ongoing obligations.

As a Hawaii state-chartered bank, the bank may only pay dividends to the extent it has retained earnings as defined under Hawaii banking law ("Statutory Retained Earnings"), which differs from GAAP retained earnings. As of June 30, 2017, the bank had Statutory Retained Earnings of \$88.6 million. On July 25, 2017, the Company's Board of Directors declared a cash dividend of \$0.18 per share on the Company's outstanding common stock, which was a 12.5% increase from the \$0.16 per share a year-ago.

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

In January 2016, the Board of Directors approved the authorization to repurchase up to \$30.0 million of the Company's common stock (the "2016 Repurchase Plan"), which superseded in its entirety the repurchase plan that was previously approved by the Board of Directors.

In January 2017, the Board of Directors approved the authorization to repurchase up to \$30.0 million of the Company's common stock (the "2017 Repurchase Plan"), which supersedes in its entirety the 2016 Repurchase Plan. As of June 30, 2017, \$18.8 million remained of the total \$30.0 million total repurchase amount authorized by the Board of Directors under the 2017 Repurchase Plan. The plan has no set expiration or termination date.

### Trust Preferred Securities

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

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## Regulatory Capital Ratios

General capital adequacy regulations adopted by the FRB and FDIC require an institution to maintain minimum leverage capital, Tier 1 risk-based capital, total risk-based capital, and common equity Tier 1 ("CET1") capital ratios. In addition to these uniform risk-based capital guidelines and leverage ratios that apply across the industry, the regulators have the discretion to set individual minimum capital requirements for specific institutions at rates significantly above the minimum guidelines and ratios. For a further discussion of the effect of forthcoming changes in required regulatory capital ratios, see the discussion in our 2016 Form 10-K "Business — Supervision and Regulation."

The Company's and the bank's leverage capital, tier 1 risk-based capital, total risk-based capital, and CET1 risk-based capital ratios as of June 30, 2017 were above the levels required for a "well capitalized" regulatory designation.

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

|                           | Actual    |        | Minimum Required for Capital Adequacy Purposes |       | Minimum Required to be Well Capitalized |       |
|---------------------------|-----------|--------|--|-------|---|-------|
|                           | Amount    | Ratio  | Amount   | Ratio | Amount                                  | Ratio |
| (dollars in thousands)    |           |        |  |       |   |       |
| Company                   |           |        |  |       |   |       |
| At June 30, 2017:         |           |        |  |       |   |       |
| Leverage capital          | \$584,441 | 10.7 % | \$ 217,867                                     | 4.0 % | \$272,334                               | 5.0 % |
| Tier 1 risk-based capital | 584,441   | 15.2   | 231,120  | 6.0   | 308,160                                 | 8.0   |
| Total risk-based capital  | 632,780   | 16.4   | 308,160  | 8.0   | 385,199                                 | 10.0  |
| CET1 risk-based capital   | 497,172   | 12.9   | 173,340  | 4.5   | 250,380                                 | 6.5   |
| At December 31, 2016:     |           |        |  |       |   |       |
| Leverage capital          | \$562,460 | 10.6 % | \$ 211,383                                     | 4.0 % | \$264,229                               | 5.0 % |
| Tier 1 risk-based capital | 562,460   | 14.2   | 237,157  | 6.0   | 316,209                                 | 8.0   |
| Total risk-based capital  | 612,202   | 15.5   | 316,209  | 8.0   | 395,261                                 | 10.0  |
| CET1 risk-based capital   | 485,268   | 12.3   | 177,868  | 4.5   | 256,920                                 | 6.5   |
| Central Pacific Bank      |           |        |  |       |   |       |
| At June 30, 2017:         |           |        |  |       |   |       |
| Leverage capital          | \$564,765 | 10.4 % | \$ 217,630                                     | 4.0 % | \$272,037                               | 5.0 % |
| Tier 1 risk-based capital | 564,765   | 14.7   | 230,754  | 6.0   | 307,673                                 | 8.0   |
| Total risk-based capital  | 612,968   | 15.9   | 307,673  | 8.0   | 384,591                                 | 10.0  |
| CET1 risk-based capital   | 564,765   | 14.7   | 173,066  | 4.5   | 249,984                                 | 6.5   |
| At December 31, 2016:     |           |        |  |       |   |       |
| Leverage capital          | \$541,577 | 10.3 % | \$ 211,135                                     | 4.0 % | \$263,918                               | 5.0 % |
| Tier 1 risk-based capital | 541,577   | 13.7   | 236,806  | 6.0   | 315,741                                 | 8.0   |
| Total risk-based capital  | 591,185   | 15.0   | 315,741  | 8.0   | 394,677                                 | 10.0  |
| CET1 risk-based capital   | 541,577   | 13.7   | 177,604  | 4.5   | 256,540                                 | 6.5   |

## Liquidity and Borrowing Arrangements

Our objective in managing liquidity is to maintain a balance between sources and uses of funds in order to economically meet the cash requirements of customers for loans and deposit withdrawals and participate in lending and investment opportunities as they arise. We monitor our liquidity position in relation to changes in loan and deposit balances on a daily basis to ensure maximum utilization, maintenance of an adequate level of readily marketable assets and access to short-term funding sources.



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

The bank is a member of and maintained a \$1.47 billion line of credit with the FHLB as of June 30, 2017, compared to \$1.41 billion at December 31, 2016. We did not have any short-term borrowings under this arrangement at June 30, 2017, compared to \$135.0 million at December 31, 2016. There were no long-term borrowings under this arrangement at June 30, 2017 and December 31, 2016. FHLB advances available at June 30, 2017 were secured by certain real estate loans with a carrying value of \$1.91 billion in accordance with the collateral provisions of the Advances, Security and Deposit Agreement with the FHLB. At June 30, 2017, \$1.47 billion was undrawn under this arrangement, compared to \$1.28 billion at December 31, 2016.

At June 30, 2017 and December 31, 2016, our bank had additional unused borrowings available at the Federal Reserve discount window of \$68.6 million and \$63.7 million, respectively. As of June 30, 2017 and December 31, 2016, certain commercial and commercial real estate loans with a carrying value totaling \$128.7 million and \$129.9 million, respectively, were pledged as collateral on our line of credit with the Federal Reserve discount window. The Federal Reserve does not have the right to sell or repledge these loans.

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

#### Contractual Obligations

Information regarding our contractual obligations is provided in "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" of our Annual Report on Form 10-K for the year ended December 31, 2016. There have been no material changes in our contractual obligations since December 31, 2016.

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

Market risk is the risk of loss in a financial instrument arising from adverse changes in market rates/prices such as interest rates, foreign currency rates, commodity prices and equity prices. Our primary market risk exposure is interest rate risk that occurs when rate-sensitive assets and rate-sensitive liabilities mature or reprice during different periods or in differing amounts. Asset/liability management attempts to coordinate our rate-sensitive assets and rate-sensitive liabilities to meet our financial objectives. The Asset/Liability Committee ("ALCO") monitors interest rate risk through the use of interest rate sensitivity gap, net interest income and market value of portfolio equity simulation, and rate shock analyses. Adverse interest rate risk exposures are managed through the shortening or lengthening of the duration of assets and liabilities.

The primary analytical tool we use to measure and manage our interest rate risk is a simulation model that projects changes in net interest income ("NII") as market interest rates change. Our ALCO policy requires that simulated changes in NII should be within certain specified ranges, or steps must be taken to reduce interest rate risk. The results of the model indicate that the mix of rate-sensitive assets and liabilities at June 30, 2017 would not result in a fluctuation of NII that would exceed the established policy limits.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As of the end of the period covered by this report and pursuant to Rule 13a-15 of the Securities Exchange Act of 1934, as amended, (the "Exchange Act"), the Company's management, including the principal executive officer and principal financial officer conducted an evaluation of the effectiveness and design of the Company's disclosure controls and procedures (as that term is defined in Rules 13a-15(e) and 15d-15(e) of the Exchange Act). Based upon that evaluation and the identification of a material weakness in the Company's internal control over financial reporting as described in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, the Company's principal executive officer and principal financial officer concluded, as of the end of the period covered by this report, that the Company's disclosure controls and procedures were not effective. See further discussion below.

### Changes in Internal Control Over Financial Reporting

As of the end of the period covered by this report, there have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) and 15d-15(f) of the Exchange Act) during the quarter to which this report relates that have materially affected or are reasonably likely to materially affect, our internal control over financial reporting, except as follows. The Company previously reported a material weakness in internal control over financial reporting over the completeness and accuracy of the information used in determining the allowance for loan and lease losses ("Allowance"). As more fully described in the Company's Annual Report on Form 10-K for the year ended December 31, 2016, in the fourth quarter of 2016, the Company implemented an enhanced Allowance methodology and a new Allowance software model. In connection with this implementation, the Company's internal controls were not properly designed or operating effectively to timely verify the completeness and accuracy of certain information which are inputs into the calculation of the Allowance reserve. Subsequent to management's determination of the material weakness, management promptly began taking the following remedial actions to address the reported weakness:

- The Company enhanced the level of data validation (completeness and accuracy testing) in critical model calculations;

- The Company established a more comprehensive management review control framework for critical data input, assumptions and results generated from the Allowance model; and

The Company engaged an independent third-party to review the Allowance methodology and calculation for conformity with U.S. generally accepted accounting principles and regulatory compliance and to validate the accuracy of the information used in the analysis.

Recently, the Company engaged an independent third-party to perform an ALLL model validation review to identify opportunities for improvement in checks and balances to the model and other change management processes. Management anticipates that these remedial actions will strengthen the Company's internal control over financial reporting and will, over time, address the material weakness that was identified as of December 31, 2016. Because some of these remedial actions will continue to take place on a quarterly basis, their successful implementation may need to be evaluated over several quarters before management can conclude that the material weakness has been remediated.

## PART II. OTHER INFORMATION

## Item 1A. Risk Factors

There have been no material changes from the Risk Factors as previously disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the SEC on March 1, 2017.

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

## Issuer Purchases of Equity Securities

In the three months ended June 30, 2017, 248,621 shares of common stock, at an aggregate cost of \$7.7 million, excluding fees and expenses, were repurchased under the share repurchase programs as described in the table below. A total of \$18.8 million remained available for repurchase under the share repurchase program at June 30, 2017.

| Period           | Issuer Purchases of Equity Securities |                              |   |  |
|------------------|---------------------------------------|------------------------------|---|--|
|                  | Total Number of Shares Purchased      | Average Price Paid per Share | Total Shares Purchased as Part of Publicly Announced Programs | Maximum Dollar Value of Shares That May Yet Be Purchased Under the Program (1) |
| April 1-30, 2017 | 66,000                                | \$ 30.07                     | 66,000  | \$ 24,538,289  |
| May 1-31, 2017   | 83,017                                | 31.28                        | 83,017  | 21,941,804   |
| June 1-30, 2017  | 99,604                                | 31.10                        | 99,604  | 18,844,388   |
| Total            | 248,621                               | \$ 30.89                     | 248,621   | \$ 18,844,388  |

(1) On January 24, 2017, our Board approved the authorization to repurchase up to \$30.0 million of the Company's common stock (the "2017 Repurchase Plan"), which superseded in its entirety the 2016 Repurchase Plan. In the three and six months ended June 30, 2017, the Company repurchased 248,621 and 360,621 shares of common stock, at an aggregate cost of \$7.7 million and \$11.2 million, under the 2017 Repurchase Plan. As of June 30, 2017, \$18.8 million remained of the total \$30.0 million total repurchase amount authorized by the Board under the 2017 Repurchase Plan. The plan has no set expiration or termination date.

Item 6. Exhibits

Exhibit No. Document

|         |   |
|---------|---|
| 31.1    | <u>Rule 13a-14(a) Certification of Chief Executive Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 *</u> |
| 31.2    | <u>Rule 13a-14(a) Certification of Chief Financial Officer in accordance with Section 302 of the Sarbanes-Oxley Act of 2002 *</u> |
| 32.1    | <u>Section 1350 Certification of Chief Executive Officer in accordance with Section 906 of the Sarbanes-Oxley Act of 2002 **</u>  |
| 32.2    | <u>Section 1350 Certification of Chief Financial Officer in accordance with Section 906 of the Sarbanes-Oxley Act of 2002 **</u>  |
| 101.INS | XBRL Instance Document*   |
| 101.SCH | XBRL Taxonomy Extension Schema Document*  |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document*  |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document*  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document*   |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document*   |

\* Filed herewith.

\*\* Furnished herewith.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CENTRAL PACIFIC FINANCIAL CORP.  
(Registrant)

Date: August 2, 2017 /s/ A. Catherine Ngo  
A. Catherine Ngo  
President and Chief Executive Officer

Date: August 2, 2017 /s/ David S. Morimoto  
David S. Morimoto  
Executive Vice President and Chief Financial Officer

Central Pacific Financial Corp.  
Exhibit Index

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