Section 1: 10-K (10-K)

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

FORM 10-K

(Mark One)

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

For the fiscal year ended December 31, 2018

or

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

Commission file number: 001-31567

Central Pacific Financial Corp.
(Exact name of registrant as specified in its charter)

Hawaii	**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)

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

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

Title of each class	Name of each exchange on which registered
Common Stock, No Par Value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☒ No ☐

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ☐ No ☒

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large Accelerated Filer ☒	Accelerated Filer ☐
Non-Accelerated Filer ☐	Smaller Reporting Company ☐
	Emerging Growth Company ☐

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 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 ☒

As of June 30, 2018, the aggregate market value of the common stock held by non-affiliates of the registrant was approximately $813,410,000. As of January 31, 2019, the number of shares of common stock of the registrant outstanding was 28,857,215 shares.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's proxy statement for the 2019 annual meeting of shareholders are incorporated by reference into Part III of this annual report on Form 10-K to the extent stated herein. The proxy

statement will be filed within 120 days after the end of the fiscal year covered by this annual report on Form 10-K.

PART I

Forward-Looking Statements and Factors that Could Affect Future Results

Certain statements contained in this annual report on Form 10-K that are not statements of historical fact constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 (the "Act"), notwithstanding that such statements are not specifically identified. In addition, certain statements may be contained in our future filings with the U.S. Securities and Exchange Commission ("SEC"), in press releases and in oral and written statements made by us or with our approval that are not statements of historical fact and constitute forward-looking statements within the meaning of the Act. Examples of forward-looking statements include but are not limited to: (i) projections of revenues, expenses, income or loss, earnings or loss per share, the payment or nonpayment of dividends, capital position and other financial items; (ii) statements of plans, objectives and expectations of Central Pacific Financial Corp. or its management or Board of Directors, including those relating to business plans, use of capital resources, products or services and regulatory developments and regulatory actions; (iii) statements of future economic performance; and (iv) statements of assumptions underlying such statements. Words such as "believes," "plans," "anticipates," "expects," "intends," "forecasts," "hopes," "targeted," "continue," "remain," "will," "should," "may" and other similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

Forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those in such statements. Factors that could cause actual results to differ from those discussed in the forward-looking statements include but are not limited to:

- increase in inventory or adverse conditions in the real estate market and deterioration in the construction industry;
- adverse changes in the financial performance and/or condition of our borrowers and, as a result, increased loan delinquency rates, deterioration in asset quality and losses in our loan portfolio;
- the impact of local, national, and international economies and events (including natural disasters such as wildfires, hurricanes, volcanic eruptions, 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 destabilization in the financial industry and deterioration of the real estate market, as well as the impact of declining levels of consumer and business confidence in the state of the economy in general and in financial institutions in particular;
- changes in estimates of future reserve requirements based upon the periodic review thereof under relevant regulatory and accounting requirements;
- the impact of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), changes in capital standards, other regulatory reform, including but not limited to regulations promulgated by the Consumer Financial Protection Bureau (the "CFPB"), government-sponsored enterprise reform, and any related rules and regulations which affect our business operations and competitiveness;
- the costs and effects of legal and regulatory developments, including legal proceedings or regulatory or other governmental inquiries and proceedings and the resolution thereof, and the results of regulatory examinations or reviews;
- the effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Board of Governors of the Federal Reserve System (the "FRB" of the "Federal Reserve");
- inflation, interest rate, securities market and monetary fluctuations, including the anticipated replacement of the London Interbank Offered Rate ("LIBOR") Index and the impact on our loans and debt which are tied to that index;
- negative trends in our market capitalization and adverse changes in the price of the Company’s common shares;
- 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 and developments;
- changes in the competitive environment among financial holding companies and other financial service providers;
- the effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board ("FASB") and other accounting standard setters and the cost and resources required to implement such changes;
- our ability to attract and retain skilled employees;
- changes in our organization, compensation and benefit plans; and
- our success at managing any of the risks involved in the foregoing items.

For information with respect to factors that could cause actual results to differ from the expectations stated in the forward-looking statements, see also "Risk Factors" under Part I, Item 1A of this report. We urge investors to consider all of these factors carefully in evaluating the forward-looking statements contained in this Form 10-K. Forward-looking statements speak only as of the date on which such statements are made. We undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date on which such statement is made, or to reflect the occurrence of unanticipated events except as required by law.

ITEM 1. BUSINESS

General

Central Pacific Financial Corp., a Hawaii corporation and bank holding company registered under the Bank Holding Company Act of 1956, as amended (the "BHC Act"), was organized on February 1, 1982. Our principal business is to serve as a holding company for our bank subsidiary, Central Pacific Bank, which was incorporated in its present form in the state of Hawaii on March 16, 1982 in connection with the holding company reorganization. Its predecessor entity was incorporated in the state of Hawaii on January 15, 1954. As of December 31, 2018, we had total assets of $5.81 billion, total loans of $4.08 billion, total deposits of $4.95 billion and shareholders' equity of $491.7 million.

When we refer to "the Company," "we," "us" or "our," we mean Central Pacific Financial Corp. and its subsidiaries on a consolidated basis. When we refer to "Central Pacific Financial Corp.," "CPF" or to the holding company, we are referring to the parent company on a standalone basis. We refer to Central Pacific Bank herein as "our bank" or "the bank."

Through our bank and its subsidiaries, we offer full-service commercial banking with 35 bank branches and 78 ATMs located throughout the state of Hawaii. Our administrative and main offices are located in Honolulu and we have 27 branches on the island of Oahu. We operate four branches on the island of Maui, two branches on the island of Hawaii and two branches on the island of Kauai. Our bank's deposits are insured by the Federal Deposit Insurance Corporation ("FDIC") up to applicable limits. The bank is not a member of the Federal Reserve System.

Central Pacific Bank is a full-service commercial bank offering a broad range of banking products and services, including accepting time and demand deposits and originating loans. Our loans include commercial loans, construction loans, commercial and residential mortgage loans and consumer loans.

We derive our income primarily from interest and fees on loans, interest on investment securities and fees received in connection with deposit and other services. Our major operating expenses are the interest paid by our bank on deposits and borrowings, salaries and employee benefits and general operating expenses. Our bank relies substantially on a foundation of locally generated deposits. For financial reporting purposes, we have the following three reportable segments: (1) Banking Operations, (2) Treasury and (3) All Others. For further information about our reporting segments, including information about the assets and operating results of each, see "Note 26 - Segment Information" in the accompanying consolidated financial statements.

Our operations, like those of other financial institutions that operate in our market, are significantly influenced by economic conditions in Hawaii, including the strength of the real estate market and the tourism industry, as well as the fiscal and regulatory policies of the federal and state government and the regulatory authorities that govern financial institutions. See the "Supervision and Regulation" section below for other information about the regulation of our holding company and bank.

Our Services

We offer a full range of banking services and products to businesses, professionals and individuals. We provide our customers with an array of loan products, including residential mortgage loans, commercial and consumer loans and lines of credit, commercial real estate loans and construction loans.

Through our bank, we concentrate our lending activities in five principal areas:

(1) *Residential Mortgage Lending.* Residential mortgage loans include fixed-rate and adjustable-rate loans primarily secured by single-family, owner-occupied residences in Hawaii and home equity lines of credit and loans. We typically require loan-to-value ratios of not more than 80%, although higher levels are permitted with accompanying mortgage insurance. First mortgage loans secured by residential properties have an average loan size of approximately $0.5 million and marketable collateral. Changes in interest rates, the economic recession and other market factors have impacted, and future changes will likely continue to impact, the marketability and value of collateral and the financial condition of our borrowers and thus the level of credit risk inherent in the portfolio. A portion of our first residential mortgage loan originations are sold in the secondary market and a portion is put into our loan portfolio.

(2) *Commercial, Financial and Agricultural Lending and Leasing.* Loans in this category consist primarily of term loans and lines of credit to small and middle-market businesses and professionals in the state of Hawaii. The borrower's business is typically regarded as the principal source of repayment, although our underwriting policies and practices generally require additional sources of collateral, including real estate and other business assets, as well as personal guarantees where possible to mitigate risk and help to reduce credit losses.

(3) *Commercial Mortgage Lending.* Loans in this category consist of loans secured by commercial real estate, including but not limited to, structures and facilities to support activities designated as multi-family residential properties, industrial, warehouse, general office, retail, health care and religious dwellings. Our underwriting policies and practices generally requires net cash flow from the property to cover the debt service while maintaining an appropriate amount of reserves and permits consideration of liquidation of the collateral as a secondary source of repayment.

(4) *Construction Lending.* Construction land development and other land loans encompasses the financing of residential and commercial construction projects.

(5) *Consumer Lending.* Loans in this category are generally either unsecured or secured by personal assets, such as automobiles, and the average loan size is generally small.

Beyond the lending function described above, we also offer a full range of deposit products and services including checking, savings and time deposits, cash management and electronic banking services, trust services and retail brokerage services.

Our Market Area and Competition

Based on deposit market share among FDIC-insured financial institutions in Hawaii, Central Pacific Bank was the fourth-largest depository institution in the state at December 31, 2018.

The banking and financial services industry in the state of Hawaii generally, and particularly in our target market areas, is highly competitive. We compete for loans, deposits and customers with other commercial banks, savings banks, securities and brokerage companies, fintech companies, mortgage companies, insurance companies, finance companies, credit unions and other nonbank financial service providers, including mortgage providers and brokers, operating via the internet and other technology platforms. Some of these competitors are much larger by total assets and capitalization, and have greater access to capital markets.

In order to compete with the other financial services providers in the state of Hawaii, we principally rely upon personal relationships between customers and our officers, directors and employees, and specialized services tailored to meet the needs of our customers and the communities we serve. We remain competitive by offering flexibility and superior service levels to our customers, coupled with competitive interest rates and pricing and local promotional activities.

For further discussion of factors affecting our operations see, "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations."

Business Concentrations

No individual or single group of related accounts is considered material in relation to the assets or deposits of our bank, or in relation to the overall business of the Company. However, approximately 74% of our loan portfolio at December 31, 2018 consisted of real estate-related loans, including residential mortgage loans, home equity loans, commercial mortgage loans and construction loans. See "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations—Financial Condition—Loan Portfolio."

Our business activities are focused primarily in Hawaii. Consequently, our results of operations and financial condition are impacted by the general economic trends in Hawaii, particularly in the commercial and residential real estate markets. During periods of economic strength, the real estate market and the real estate industry typically perform well; during periods of economic weakness, they typically are adversely affected.

Our Subsidiaries

Central Pacific Bank is the wholly-owned principal subsidiary of Central Pacific Financial Corp. As of December 31, 2018, other wholly-owned subsidiaries include: CPB Capital Trust II; CPB Statutory Trust III; CPB Capital Trust IV; and CPB Statutory Trust V. CPB Capital Trust II and CPB Statutory Trust III were terminated in January 2019.

As of December 31, 2018, Central Pacific Bank does not have any wholly-owned subsidiaries. Central Pacific Bank owns 50% of Gentry HomeLoans, LLC, Haseko HomeLoans, LLC and Island Pacific HomeLoans, LLC. Pacific Access Mortgage, LLC and One Hawaii HomeLoans, LLC were terminated in 2017, and final payment of taxes and distributions to members were made in 2018.

Supervision and Regulation

General

The Company and the bank are subject to significant regulation and restrictions by federal and state laws and regulatory agencies for the protection of depositors and the FDIC deposit insurance fund, borrowers, and the stability of the U.S. banking system. The following discussion of statutes and regulations is a summary and does not purport to be complete nor does it address all applicable statutes and regulations. This discussion is also qualified in its entirety by reference to the statutes and regulations referred to in this discussion. We cannot predict whether or when new legislative initiatives may be proposed or enacted or new regulations or guidance may be promulgated nor the effect new laws, regulations and supervisory policies and practices may have on community banks generally or on our financial condition and results of operations. Such developments could increase or decrease the cost of doing business, limit or expand permissible activities or affect the competitive balance among banks, savings associations, credit unions and other financial institutions. In addition, President Trump has announced generally that he intends to scale back regulatory requirements on businesses. We also cannot predict whether or when regulatory requirements may be reduced or eliminated and the overall affect such reduction or elimination may have on the Company and the bank.

Regulatory Agencies

Central Pacific Financial Corp. is a legal entity separate and distinct from its subsidiaries. As a bank holding company for Central Pacific Bank, Central Pacific Financial Corp. is regulated under the BHC Act and is subject to inspection, examination and supervision by the FRB. It is also subject to Hawaii's Code of Financial Institutions and is subject to inspection, examination and supervision by the Hawaii Division of Financial Institutions ("DFI".)

The Company is subject to the disclosure and regulatory requirements of the Securities Act of 1933, as amended, and the Securities Exchange Act of 1934, as amended (the "Exchange Act"), as administered by the SEC. Our common stock is listed on the New York Stock Exchange ("NYSE") under the trading symbol "CPF," and we are subject to the rules of the NYSE for companies listed there. In addition to the powers of the bank regulatory agencies we are subject to, the SEC and the NYSE have the ability to take enforcement actions against us.

The Company is also subject to the accounting oversight and corporate governance requirements of the Sarbanes-Oxley Act of 2002, including, among other things, required executive certification of financial presentations, requirements for board audit committees and their members, and disclosure of controls and procedures and internal control over financial reporting.

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

Legislative and Regulatory Developments

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

Improving regulatory efficiency and effectiveness by critically evaluating mandates and regulatory fragmentation, overlap, and duplication across regulatory agencies;

- Aligning the financial system to help support the U.S. economy;
- Reducing regulatory burden by decreasing unnecessary complexity;
- Tailoring the regulatory approach based on size and complexity of regulated firms and requiring greater regulatory cooperation and coordination among financial regulators; and
- Aligning regulations to support market liquidity, investment, and lending in the U.S. economy.

The scope and breadth of regulatory changes that will be implemented in response to the President’s executive order have not yet been determined.

On December 22, 2017, the U.S. government enacted comprehensive tax legislation H.R.1., commonly referred to as the Tax Cuts and Jobs Act ("Tax Reform"), which among other items, reduced the corporate federal income tax rate from 35% to 21% and changed or limited certain tax deductions effective January 1, 2018. In response to the enactment of Tax Reform, in December 2017, the Company paid special, one-time bonuses to all employees with the exception of executives on its managing committee. Secondly, the Company raised its minimum starting pay rate and increased the pay rate above the minimum rate for certain positions twice during the year, effective January 1, 2018 and December 1, 2018. Additionally, the Company increased its quarterly cash dividend payable in March 2018 and June 2018 to $0.19 and $0.21 per common share, respectively, and reiterated its intent to maintain a dividend payout ratio comparable to its peers. Finally, the Company plans to evaluate additional opportunities to utilize the savings from the reduced corporate income tax rate.

Capital Adequacy Requirements

Bank holding companies and banks are subject to various regulatory capital requirements administered by state and federal banking agencies. The New Capital Rules became fully effective on January 1, 2015, but many elements are being phased in over multiple future years. The risk-based capital guidelines for bank holding companies and banks require capital ratios that vary based on the perceived degree of risk associated with a banking organization's operations for both transactions reported on the balance sheet as assets, such as loans, and those recorded as off-balance sheet items, such as commitments, letters of credit and recourse arrangements. The risk-based capital ratio is determined by classifying assets and certain off-balance sheet financial instruments into weighted categories, with higher levels of capital being required for those categories perceived as

representing greater risks and dividing its qualifying capital by its total risk-adjusted assets and off-balance sheet items. Bank holding companies and banks engaged in significant trading activity may also be subject to the market risk capital guidelines and be required to incorporate additional market and interest rate risk components into their risk-based capital standards. To the extent that the new rules are not fully phased in, the prior capital rules continue to apply.

The New Capital Rules revised the previous risk-based and leverage capital requirements for banking organizations to meet requirements of the Dodd—Frank Act and to implement the Basel III international agreements reached by the Basel Committee. Although many of the rules contained in these final regulations are applicable only to large, internationally active banks, some of them apply on a phased-in basis to all banking organizations, including the Company and the bank. Management believes that, as of December 31, 2018, the Company and the bank would meet all applicable capital requirements under the New Capital Rules on a fully phased-in basis if such requirements were currently in effect. If the Company were to cross the $10 billion or more asset threshold, its compliance costs and regulatory requirements, would increase.

Under the risk-based capital guidelines in place prior to the effectiveness of the New Capital Rules, there were three fundamental capital ratios: a total risk-based capital ratio, a Tier 1 risk-based capital ratio and a Tier 1 leverage ratio. To be deemed "well capitalized," a bank must have a total risk-based capital ratio, a Tier 1 risk-based capital ratio and a Tier 1 leverage ratio of at least 10%, 6% and 5%, respectively.

The following are among the new capital rules that were phased-in beginning January 1, 2015:

- an increase in the minimum Tier 1 capital ratio from 4% to 6% of risk-weighted assets;
- a new category and a required 4.5% of risk-weighted assets ratio is established for common equity Tier 1 ("CET1") as a subset of Tier 1 capital limited to common equity;
- a minimum non-risk-based leverage ratio is set at 4%;
- changes in the permitted composition of Tier 1 capital to exclude trust preferred securities subject to certain grandfathering exceptions for organizations like the Company which were under $15 billion in assets as of December 31, 2009, mortgage servicing rights and certain deferred tax assets and include unrealized gains and losses on available for sale debt and equity securities unless the organization opts out of including such unrealized gains and losses, which the Company elected to do in 2015;
- the risk-weights of certain assets for purposes of calculating the risk-based capital ratios are changed for high volatility commercial real estate acquisition, development and construction loans, certain past due non-residential mortgage loans and certain mortgage-backed and other securities exposures; and
- an additional "countercyclical capital buffer" is required for larger and more complex institutions.
- an additional capital conservation buffer of 2.5% of risk weighted assets above the regulatory minimum capital ratios established under the new final capital rule was phased in over four years beginning in 2016 at the rate of 0.625% of risk-weighted assets (1.25% in 2017, 1.875% in 2018 and 2.5% in 2019) and must be met to avoid limitations on the ability of the bank to pay dividends, repurchase shares or pay discretionary bonuses.

Including the capital conservation buffer of 2.5%, the new final capital rule results in the following minimum ratios to be considered well capitalized: (i) a Tier 1 capital ratio of 8.5%, (ii) a common equity Tier 1 capital ratio of 7%, and (iii) a total capital ratio of 10.5%. At December 31, 2018, the respective capital ratios of the Company and the bank exceeded the minimum percentage requirements to be deemed "well-capitalized" for regulatory purposes. - See the "Capital Resources" section in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A").

While the New Capital Rules set higher regulatory capital standards for the Company and the bank, bank regulators may also continue their past policies of expecting banks to maintain additional capital beyond the new minimum requirements which could adversely impact the Company's net income and return on equity, restrict the ability to pay dividends or executive bonuses and require the raising of additional capital.

In September 2017, the federal bank regulators proposed to revise and simplify the capital treatment for certain deferred tax assets, mortgage servicing assets, investments in non-consolidated financial entities and minority interests for banking organizations, such as the Company and the bank, that are not subject to the advanced approaches requirements. In November 2017, the federal banking regulators revised the Basel III Capital Rules to extend the current transitional treatment of these

items for non-advanced approaches banking organizations until the September 2017 proposal is finalized. The September 2017 proposal would also change the capital treatment of certain commercial real estate loans under the standardized approach, which we use to calculate our capital ratios.

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

Prompt Corrective Action Provisions

The Federal Deposit Insurance Act requires the federal bank regulatory agencies to take "prompt corrective action" with respect to a depository institution if that institution does not meet certain capital adequacy standards, including requiring the prompt submission of an acceptable capital restoration plan. Depending on the bank's capital ratios, the agencies' regulations define five categories in which an insured depository institution will be placed: well-capitalized, adequately capitalized, undercapitalized, significantly undercapitalized, and critically undercapitalized. At each successive lower capital category, an insured bank is subject to more restrictions, including restrictions on the bank's activities, operational practices or the ability to pay dividends or executive bonuses. Based upon its capital levels, a bank that is classified as well-capitalized, adequately capitalized, or undercapitalized may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment.

The prompt corrective action standards were also changed as the New Capital Rules ratios became effective. Under the new standards, in order to be considered well-capitalized, the bank will be required to meet the new common equity Tier 1 ratio of 6.5%, an increased Tier 1 ratio of 8% (increased from 6%), a total capital ratio of 10% (unchanged) and a leverage ratio of 5% (unchanged).

The federal banking agencies also may require banks and bank holding companies subject to enforcement actions to maintain capital ratios in excess of the minimum ratios otherwise required to be deemed well capitalized, in which case institutions may no longer be deemed to be well capitalized and may therefore be subject to certain restrictions on items such as brokered deposits.

Volcker Rule

In December 2013, the federal bank regulatory agencies adopted final rules that implement a part of the Dodd-Frank Act commonly referred to as the "Volcker Rule." Under these rules and subject to certain exceptions, banking entities are restricted from engaging in activities that are considered proprietary trading and from sponsoring or investing in certain entities, including hedge or private equity funds that are considered "covered funds." These rules became effective on April 1, 2014, although certain provisions are subject to delayed effectiveness under rules promulgated by the FRB. The Company and the bank held no investment positions at December 31, 2018 which were subject to the final rule. Therefore, while these new rules may require us to conduct certain internal analysis and reporting, they did not require any material changes in our operations or business.

Bank Holding Company Regulation

As contained in both federal and state banking laws and regulations, a wide range of requirements and restrictions apply to bank holding companies and their subsidiaries which:

- require regular periodic reports and such additional reports of information as the Federal Reserve may require;
- require bank holding companies to meet or exceed minimum capital requirements (see the "Capital Adequacy Requirements" section above and the "Capital Resources" section in the MD&A);

- require that bank holding companies serve as a source of financial and managerial strength to subsidiary banks and commit resources as necessary to support each subsidiary bank. The source-of-strength doctrine most directly affects bank holding companies where a bank holding company's subsidiary bank fails to maintain adequate capital levels. In such a situation, the subsidiary bank will be required by the bank's federal regulator to take "prompt corrective action" (see the "Prompt Corrective Action Provisions" section above);

- limit dividends payable to shareholders and restrict the ability of bank holding companies to obtain dividends or other distributions from their subsidiary banks;

- require a bank holding company to terminate an activity or terminate control of or liquidate or divest certain subsidiaries, affiliates or investments if the Federal Reserve believes the activity or the control of the subsidiary or affiliate constitutes a significant risk to the financial safety, soundness or stability of any bank subsidiary;

- require the prior approval for changes in senior executive officers or directors and prohibit golden parachute payments, including change in control agreements, or new employment agreements with such payment terms, which are contingent upon termination when a bank holding company is deemed to be in troubled condition;

- regulate provisions of certain bank holding company debt, including the authority to impose interest ceilings and reserve requirements on such debt and require prior approval to purchase or redeem securities in certain situations;

- require prior approval for the acquisition of 5% or more of the voting stock of a bank or bank holding company by bank holding companies or other acquisitions and mergers with other banks or bank holding companies and consider certain competitive, management, financial, and anti-money laundering compliance impact on the U.S.; and

- require prior notice and/or prior approval of the acquisition of control of a bank or a bank holding company by a shareholder or individuals acting in concert with ownership or control of 10% of the voting stock being a presumption of control.

Other Restrictions on the Company's Activities

Subject to prior notice or Federal Reserve approval, bank holding companies may generally engage in, or acquire shares of companies engaged in, activities determined by the Federal Reserve to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. Bank holding companies that elect and retain "financial holding company" status pursuant to the Gramm-Leach-Bliley Act of 1999 ("GLBA") may engage in these nonbanking activities and broader securities, insurance, merchant banking and other activities that are determined to be "financial in nature" or are incidental or complementary to activities that are financial in nature without prior Federal Reserve approval. Pursuant to the GLBA and the Dodd-Frank Act, in order to elect and retain financial holding company status, a bank holding company and all depository institution subsidiaries of that bank holding company must be well capitalized and well managed, and, except in limited circumstances, depository subsidiaries must be in satisfactory compliance with the Community Reinvestment Act ("CRA"), which requires banks to help meet the credit needs of the communities in which they operate. Failure to sustain compliance with these requirements or correct any non-compliance within a fixed time period could lead to the required divestiture of subsidiary banks or the termination of all activities that do not conform to those permissible for a bank holding company. The Company has not elected financial holding company status and neither the Company nor the bank has engaged in any activities determined by the Federal Reserve to be financial in nature or incidental or complementary to activities that are financial in nature.

Dividends

It is the Federal Reserve's policy that bank holding companies should generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. It is also the Federal Reserve's policy that bank holding companies should not maintain dividend levels that undermine their ability to be a source of strength to their banking subsidiaries. The Federal Reserve has also discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. The Company is also subject to restrictions on dividends under applicable Hawaii law.

The bank is a legal entity that is separate and distinct from its holding company. CPF is dependent on the performance of the bank for funds which may be received as dividends from the bank for use in the operation of CPF and the ability of CPF to pay dividends to shareholders. Subject to regulatory and statutory restrictions, including restrictions under applicable Hawaii law,

future cash dividends by the bank will depend upon management's assessment of future capital requirements, contractual restrictions and other factors.

Regulation of the Bank

As a Hawaii state-chartered bank whose deposits are insured by the FDIC, the bank is subject to regulation, supervision, and regular examination by the DFI and by the FDIC as a state nonmember bank, as the bank's primary Federal regulator. Specific federal and state laws and regulations which are applicable to banks regulate, among other things, the scope of their business, their investments, their reserves against deposits, the timing of the availability of deposited funds, their activities relating to dividends, investments, loans, the nature and amount of collateral for certain loans, servicing and foreclosing on loans, transactions with affiliates, officers, directors and other insiders, borrowings, capital requirements, certain check-clearing activities, branching, and mergers and acquisitions.

FDIC and DFI Enforcement Authority

The federal and Hawaii regulatory structure gives the bank regulatory agencies extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves for regulatory purposes. The regulatory agencies have adopted guidelines to assist in identifying and addressing potential safety and soundness concerns before an institution's capital becomes impaired. The guidelines establish operational and managerial standards generally relating to: (1) internal controls, information systems, and internal audit systems; (2) loan documentation; (3) credit underwriting; (4) interest-rate exposure; (5) asset growth and asset quality; and (6) compensation, fees, and benefits. Further, the regulatory agencies have adopted safety and soundness guidelines for asset quality and for evaluating and monitoring earnings to ensure that earnings are sufficient for the maintenance of adequate capital and reserves. If, as a result of an examination, the DFI or the FDIC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, market sensitivity, or other aspects of the bank's operations are unsatisfactory or that the bank or its management is violating or has violated any law or regulation, the DFI and the FDIC, and separately the FDIC as insurer of the bank's deposits, have residual authority to:

- require affirmative action to correct any conditions resulting from any violation or practice;

- direct an increase in capital and the maintenance of higher specific minimum capital ratios, which may preclude the bank from being deemed well capitalized and restrict its ability to accept certain brokered deposits;

- restrict the bank's growth geographically, by products and services, or by mergers and acquisitions, including bidding in FDIC receiverships for failed banks;

- enter into or issue informal or formal enforcement actions, including required Board resolutions, memoranda of understanding, written agreements and consent or cease and desist orders or prompt corrective action orders to take corrective action and cease unsafe and unsound practices;

- require prior approval of senior executive officer or director changes; remove officers and directors and assess civil monetary penalties; and

- terminate FDIC insurance, revoke the charter and/or take possession of and close and liquidate the bank or appoint the FDIC as receiver, which for a Hawaii state-chartered bank would result in a revocation of its charter.

Deposit Insurance

The FDIC is an independent federal agency that insures deposits through the Deposit Insurance Fund (the "DIF") up to prescribed statutory limits of federally insured banks and savings institutions and safeguards the safety and soundness of the banking and savings industries. The Dodd-Frank Act revised the FDIC's DIF management authority by setting requirements for the Designated Reserve Ratio (the "DRR", calculated as the DIF balance divided by estimated insured deposits) and redefining the assessment base which is used to calculate banks' quarterly assessments. The amount of FDIC assessments paid by each DIF member institution is based on its asset size and its relative risk of default as measured by regulatory capital ratios and other supervisory factors. We are generally unable to control the amount of premiums that we are required to pay for FDIC insurance. On September 30, 2018, the DRR reached 1.36%. Because the reserve ratio has exceeded 1.35%, two deposit insurance assessment changes occurred under the FDIC regulations: 1) Surcharges on large banks (total consolidated assets of $10 billion or more) ended; the last surcharge on large banks was collected on December 28, 2018. and 2) Small banks (total

consolidated assets of less than $10 billion) were awarded assessment credits for the portion of their assessments that contributed to the growth in the reserve ratio from 1.15% to 1.35%, to be applied when the reserve ratio is at least 1.38%.

If there are additional bank or financial institution failures or if the FDIC otherwise determines, we may be required to pay higher FDIC premiums. Any future increases in FDIC insurance premiums may have a material and adverse effect on our earnings and could have a material adverse effect on the value of, or market for, our common stock.

Compensation

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

Cybersecurity

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

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

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

Office of Foreign Assets Control Regulation

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

Operations and Consumer Compliance Laws

The bank must comply with numerous federal and state anti-money laundering and consumer protection and privacy statutes and implementing regulations, including the USA Patriot Act of 2001, GLBA, the Bank Secrecy Act, the Foreign Account Tax Compliance Act, the CRA, the Fair Debt Collection Practices Act, the Fair Credit Reporting Act, as amended by the Fair and Accurate Credit Transactions Act, the Equal Credit Opportunity Act, the Truth in Lending Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, the National Flood Insurance Act, and various federal and state privacy protection laws, including the Telephone Consumer Protection Act and the CAN-SPAM Act. Noncompliance with these laws could subject the bank to lawsuits and could also result in administrative penalties, including, fines and reimbursements. CPF and the bank are also subject to federal and state laws prohibiting unfair or fraudulent business practices, untrue or misleading advertising and unfair competition.

These laws and regulations mandate certain disclosure and reporting requirements and regulate the manner in which financial institutions must deal with customers when taking deposits, making loans, servicing, collecting, and foreclosure of loans, and providing other services. Failure to comply with these laws and regulations can subject the bank to various penalties, including but not limited to enforcement actions, injunctions, fines or criminal penalties, punitive damages, and the loss of certain contractual rights.

The bank received an "Outstanding" rating in the FDIC's 2017 Community Reinvestment Act performance evaluation that measures how financial institutions support their communities in the areas of lending, investment and service.

CFPB

The Dodd-Frank Act provided for the creation of the CFPB as an independent entity with broad rulemaking, supervisory and enforcement authority over consumer financial products and services, including deposit products, residential mortgages, home equity loans and credit cards. The CFPB's functions include investigating consumer complaints, conducting market research, rulemaking, and enforcing rules related to consumer financial products and services. CFPB regulations and guidance apply to all covered persons, and banks with $10 billion or more in assets are subject to supervision including examination by the CFPB. Banks with less than $10 billion in assets, including the bank, will continue to be examined for compliance by their primary federal banking agency.

The CFPB has finalized a number of significant rules which impact nearly every aspect of the lifecycle of a residential mortgage loan. These rules implement the Dodd-Frank Act amendments to the Equal Credit Opportunity Act, the Truth in Lending Act and the Real Estate Settlement Procedures Act. Among other things, the rules adopted by the CFPB require covered persons including banks making residential mortgage loans to: (i) develop and implement procedures to ensure compliance with an "ability-to-repay" test and identify whether a loan meets a new definition for a "qualified mortgage", in which case a rebuttable presumption exists that the creditor extending the loan has satisfied the ability-to-repay test; (ii) implement new or revised disclosures, policies and procedures for originating and servicing mortgages including, but not limited to, pre-loan counseling, early intervention with delinquent borrowers and specific loss mitigation procedures for loans secured by a borrower's principal residence; (iii) comply with additional restrictions on mortgage loan originator hiring and compensation; (iv) comply with new disclosure requirements and standards for appraisals and certain financial products; and (v) maintain escrow accounts for higher-priced mortgage loans for a longer period of time.

The review of products and practices to prevent unfair, deceptive or abusive acts or practices ("UDAAP") has been a focus of the CFPB, and of banking regulators more broadly. In addition, the Dodd-Frank Act provides the CFPB with broad supervisory, examination and enforcement authority over various consumer financial products and services, including the ability to require reimbursements and other payments to customers for alleged violations of UDAAP and other legal requirements and to impose

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

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

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

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

Commercial Real Estate Concentration Limits

In December 2006, the federal banking regulators issued guidance entitled "Concentrations in Commercial Real Estate Lending, Sound Risk Management Practices" to address increased concentrations in commercial real estate and construction, or "CRE", loans. In addition, in December 2015, the federal bank agencies issued additional guidance entitled "Statement on Prudent Risk Management for Commercial Real Estate Lending." Together, these guidelines describe the criteria the agencies will use as indicators to identify institutions potentially exposed to CRE concentration risk. An institution that has (i) experienced rapid growth in CRE lending, (ii) notable exposure to a specific type of CRE, (iii) total reported loans for construction, land development, and other land representing 100% or more of the institution's capital, or (iv) total CRE loans representing 300% or more of the institution's capital, and the outstanding balance of the institutions CRE portfolio has increased by 50% or more in the prior 36 months, may be identified for further supervisory analysis of the level and nature of its CRE concentration risk. As of December 31, 2018, the bank's construction, land development, and other land and total CRE loans represented 13.6% and 225.2% of its capital, respectively.

Future Legislation and Regulation

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

Employees

At December 31, 2018, we employed 844 persons, 773 on a full-time basis and 71 on a part-time basis. We are not a party to any collective bargaining agreement.

Available Information

Our internet website can be found at www.centralpacificbank.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and all amendments to those reports can be found on our internet website as soon as reasonably practicable after such materials are electronically filed with or furnished to the SEC. Copies of the Company's filings with the SEC may also be obtained directly from the SEC's website at www.sec.gov. These documents may also be obtained in print upon request by our shareholders to our Investor Relations Department.

Also posted on our website and available in print upon request of any shareholder to our Investor Relations Department, are the charters for our Audit Committee, Compensation Committee and Corporate Governance Committee, as well as our Corporate Governance Guidelines and Code of Business Conduct and Ethics. Within the time period required by the SEC and NYSE, we will post on our website any amendment to the Code of Business Conduct and Ethics and any waiver applicable to our senior financial officers, as defined by the SEC, and our executive officers or directors. In addition, our website includes information concerning purchases and sales of our equity securities by our executive officers and directors, as well as disclosure relating to certain non-GAAP financial measures (as defined in the SEC's Regulation G) that we may make public orally, telephonically, by webcast, by broadcast or by similar means from time to time.

ITEM 1A. RISK FACTORS

Our business faces significant risks, including credit, market/liquidity, operational, legal/regulatory and strategic/reputation risks. The factors described below may not be the only risks we face and are not intended to serve as a comprehensive listing or be applicable only to the category of risk under which they are disclosed. The risks described below are generally applicable to more than one of the following categories of risks. Additional risks that we do not yet know of or that we currently think are immaterial may also impair our business operations. If any of the events or circumstances described in the following factors actually occurs, our business, financial condition and/or results of operations could be materially and adversely affected.

Risk Factors Related to our Business

Negative developments in the global and U.S. economies could have an adverse effect on us.

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

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

Unlike larger national or other regional banks that are more geographically diversified, our business and operations are closely tied to the Hawaii market. The Hawaii economy relies on tourism, real estate, government and other service-based industries. Declines in tourism, increases in energy costs, the availability of affordable air transportation, adverse weather and natural disasters, and local budget issues impact consumer and corporate spending. As a result, such events may contribute to the deterioration in Hawaii's general economic condition, which could adversely impact us and our borrowers.

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

Our real estate loan operations have a considerable effect on our results of operations.

The performance of our real estate loans depends on a number of factors, including the continued improvement of the real estate markets in which we operate. As we have previously seen in the Hawaii and California construction and real estate markets, the strength of the real estate market and the results of our operations could be negatively affected by an economic downturn.

In addition, declines in the market for commercial property could cause some of our borrowers to suffer losses on their projects, which would negatively affect our financial condition, results of operations and prospects. Declines in housing prices and the supply of existing houses for sale could cause residential developers who are our borrowers to suffer losses on their projects and encounter difficulty in repaying their loans. We cannot assure you that we will have an adequate allowance for loan and lease losses to cover future losses. If we suffer greater losses than we are projecting, our financial condition and results of operations would be adversely affected.

Our allowance for loan and lease loss methodology has resulted in credits to our provision for loan and lease losses but the credit provisions may not continue.

For eight consecutive years from 2011 through 2018, we recorded a credit to the provision for loan and lease losses. Under typical stable portfolio and market conditions, we would generally record a provision for loan and leases losses when there is

growth in our loan portfolio. Although other factors of our overall risk profile have improved in recent years and general economic trends and market conditions have stabilized, concerns over the global and U.S. economies still remain. Accordingly, it is possible that the real estate markets we participate in could deteriorate as it did from the latter part of 2007 through 2010. If this occurs, it may result in an increase in loan delinquencies, loan charge-offs, and our allowance for loan and lease losses. Even if economic conditions improve or stay the same, it is possible that we may experience material credit losses and in turn, increases to our allowance for loan and lease losses, due to any number of factors, including but not limited to, the inherent risk in our existing loan portfolio resulting from our high concentration of loans collateralized by real estate. If that were to occur, we may have to record a provision for loan and lease losses which would have an adverse impact on our net income.

A large percentage of our loans are collateralized by real estate and any deterioration in the real estate market may result in additional losses and adversely affect our financial results.

Our results of operations have been, and in future periods, will continue to be significantly impacted by the economy in Hawaii, and to a lesser extent, other markets we are exposed to including California. Approximately 74% of our loan portfolio as of December 31, 2018 was comprised of loans primarily collateralized by real estate, with the significant majority of these loans concentrated in Hawaii.

Deterioration of the economic environment in Hawaii, California or other markets we are exposed to, including a decline in the real estate market and single-family home resales or a material external shock, may significantly impair the value of our collateral and our ability to sell the collateral upon foreclosure. In the event of a default with respect to any of these loans, amounts received upon sale of the collateral may be insufficient to recover outstanding principal and interest on the loan. As we have seen in the past, material declines in the value of the real estate assets securing many of our commercial real estate loans may lead to significant credit losses in this portfolio. As a result of our particularly high concentration of real estate loans, our portfolio had been and remains particularly susceptible to significant credit losses during economic downturns and adverse changes in the real estate market.

Our allowance for loan and lease losses may not be sufficient to cover actual loan losses, which could adversely affect our results of operations. Additional loan losses may occur in the future and may occur at a rate greater than we have experienced to date.

As a lender, we are exposed to the risk that our loan customers may not repay their loans according to their terms and that the collateral or guarantees securing these loans may be insufficient to assure repayment. Our current allowance for loan and lease losses may not be sufficient to cover future loan losses. We may experience significant loan losses that could have a material adverse effect on our operating results. Management makes various assumptions and judgments about the collectibility of our loan portfolio, which are regularly reevaluated and are based in part on:

- current economic conditions and their estimated effects on specific borrowers;
- an evaluation of the existing relationships among loans, potential loan losses and the present level of the allowance for loan and lease losses;
- results of examinations of our loan portfolios by regulatory agencies; and
- management's internal review of the loan portfolio.

In determining the size of the allowance for loan and lease losses, we rely on an analysis of our loan portfolio, our experience and our evaluation of general economic conditions. If our assumptions prove to be incorrect, our current allowance for loan and lease losses may not be sufficient to cover the losses. Because of the uncertainty in the economy, volatility in the credit and real estate markets, including specifically, the deterioration in the Hawaii and California real estate markets and our high concentration of real estate loans, we made significant enhancements to our allowance for loan and lease losses methodology over the past several years and may need to make additional enhancements in the future. In addition, third parties, including our federal and state regulators, periodically evaluate the adequacy of our allowance for loan and lease losses and may communicate with us concerning the methodology or judgments that we have raised in determining the allowance for loan and lease losses. As a result of this input, we may be required to assign different grades to specific credits, increase our provision for loan and lease losses, and/or recognize further loan charge offs. See Note 1 - Summary of Significant Accounting Policies.

The implementation of CECL, including the design and maintenance of related internal controls over financial reporting, will require a significant amount of time and resources which may have a material impact on our results of operations.

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

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

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

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

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

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

Our loan portfolio includes commercial, financial and agricultural loans and commercial real estate loans, which are secured by commercial real estate, including but not limited to, structures and facilities to support activities designated as multi-family residential properties, industrial, warehouse, general office, retail, health care and religious dwellings. Commercial, financial and agricultural and commercial real estate loans carry more risk as compared to other types of lending, because they typically involve larger loan balances often concentrated with a single borrower or groups of related borrowers.

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

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

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

limit our ability to leverage our capital and have a material adverse effect on our business, financial condition, results of operations and prospects.

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

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

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

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

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

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

Our ability to maintain adequate sources of funding and liquidity and required capital levels may be negatively impacted by uncertainty in the economic environment which may, among other things, impact our ability to satisfy our obligations.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of investments or loans, and other sources would have a substantial negative effect on our liquidity which could affect or limit our ability to satisfy our obligations and our ability to grow profitability at the same rate. Our access to funding sources in amounts adequate to finance our activities on terms that are acceptable to us could be impaired by factors that affect us specifically, the financial services industry, or the economy in general. Factors that could detrimentally impact our access to liquidity sources include concerns regarding deterioration in our financial condition, increased regulatory actions against us and a decrease in the level of our business activity as a result of a downturn in the markets in which our loans or deposits are concentrated. Our ability to borrow could also be impaired by factors that are not specific to us, such as a disruption in the financial markets or negative views and expectations about the prospects for the financial industry in light of the past turmoil faced by banking organizations and the credit markets.

The management of liquidity risk is critical to the management of our business and our ability to service our customer base. In managing our balance sheet, our primary source of funding is customer deposits. Our ability to continue to attract these deposits and other funding sources is subject to variability based upon a number of factors including volume and volatility in

the securities' markets, our financial condition, our credit rating and the relative interest rates that we are prepared to pay for these liabilities. The availability and level of deposits and other funding sources is highly dependent upon the perception of the liquidity and creditworthiness of the financial institution, and perception can change quickly in response to market conditions or circumstances unique to a particular company. Concerns about our past and future financial condition or concerns about our credit exposure to other parties could adversely impact our sources of liquidity, financial position, including regulatory capital ratios, results of operations and our business prospects.

If our level of deposits were to materially decrease, we would need to raise additional funds by increasing the interest that we pay on certificates of deposits or other depository accounts, seek other debt or equity financing or draw upon our available lines of credit. We rely on commercial and retail deposits, and to a lesser extent, advances from the Federal Home Loan Bank of Des Moines ("FHLB") and the Federal Reserve discount window, to fund our operations. Although we have historically been able to replace maturing deposits and advances as necessary, we might not be able to replace such funds in the future if, among other things, our results of operations or financial condition or the results of operations or financial condition of the FHLB or market conditions were to change.

Our line of credit with the FHLB serves as a primary outside source of liquidity. The Federal Reserve discount window also serves as an additional outside source of liquidity. Borrowings under this arrangement are through the Federal Reserve's primary facility under the borrower-in-custody program. The duration of borrowings from the Federal Reserve discount window are generally for a very short period, usually overnight. In the event that these outside sources of liquidity become unavailable to us, we will need to seek additional sources of liquidity, including selling assets. We cannot assure you that we will be able to sell assets at a level to allow us to repay borrowings or meet our liquidity needs.

We constantly monitor our activities with respect to liquidity and evaluate closely our utilization of our cash assets; however, there can be no assurance that our liquidity or the cost of funds to us may not be materially and adversely impacted as a result of economic, market, or operational considerations that we may not be able to control.

Our business is subject to interest rate risk and fluctuations in interest rates may adversely affect our earnings.

The majority of our assets and liabilities are monetary in nature and subject to risk from changes in interest rates. Like most financial institutions, our earnings and profitability depend significantly on our net interest income, which is the difference between interest income on interest-earning assets, such as loans and investment securities, and interest expense on interest-bearing liabilities, such as deposits and borrowings. We expect that we will periodically experience "gaps" in the interest rate sensitivities of our assets and liabilities, meaning that either our interest-bearing liabilities will be more sensitive to changes in market interest rates than our interest-earning assets, or vice versa. If market interest rates should move contrary to our position, this "gap" will work against us and our earnings may be negatively affected. In light of our current volume and mix of interest-earning assets and interest-bearing liabilities, our net interest margin could be expected to remain relatively constant during periods of rising interest rates, and to decline slightly during periods of falling interest rates. We are unable to predict or control fluctuations of market interest rates, which are affected by many factors, including the following:

- inflation;
- recession;
- changes in unemployment;
- the money supply;
- international disorder and instability in domestic and foreign financial markets; and
- governmental actions.

Our asset/liability management strategy may not be able to control our risk from changes in market interest rates and it may not be able to prevent changes in interest rates from having a material adverse effect on our results of operations and financial condition. From time to time, we may reposition our assets and liabilities to reduce our net interest income volatility. Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Governmental regulation and regulatory actions against us may impair our operations or restrict our growth.

As a regulated financial institution, we are subject to significant governmental supervision and regulation. These regulations affect our lending practices, capital structure, investment practices, dividend policy and growth, among other things. Congress and federal regulatory agencies continually review banking laws, regulations and policies for possible changes. Statutes and regulations affecting our business may be changed at any time and the interpretation of these statutes and regulations by examining authorities may also change. In addition, regulations may be adopted which increase our deposit insurance premiums and enact special assessments which could increase expenses associated with running our business and adversely affect our earnings.

There can be no assurance that such statutes and regulations, any changes thereto or to their interpretation will not adversely affect our business. In particular, these statutes and regulations, and any changes thereto, could subject us to additional costs (including legal and compliance costs), limit the types of financial services and products we may offer and/or increase the ability of non-banks to offer competing financial services and products, among other things. In addition to governmental supervision and regulation, we are subject to changes in other federal and state laws, including changes in tax laws, which could materially affect us and the banking industry generally. We are subject to the rules and regulations of the FRB, the FDIC and the DFI, and certain rules and regulations promulgated by the CFPB. In addition, we are subject to the rules and regulation of the NYSE and the SEC and are subject to enforcement actions and other punitive actions by these agencies. If we fail to comply with federal and state regulations, the regulators may limit our activities or growth, impose fines on us or in the case of our bank regulators, ultimately require our bank to cease its operations. Bank regulations can hinder our ability to compete with financial services companies that are not regulated in the same manner or are less regulated. Federal and state bank regulatory agencies regulate many aspects of our operations. These areas include:

- the capital that must be maintained;
- the kinds of activities that can be engaged in;
- the kinds and amounts of investments that can be made;
- the locations of offices;
- insurance of deposits and the premiums that we must pay for this insurance;
- procedures and policies we must adopt;
- conditions and restrictions on our executive compensation; and
- how much cash we must set aside as reserves for deposits.

In addition, bank regulatory authorities may bring enforcement actions against banks and bank holding companies, including CPF and the bank, for unsafe or unsound practices in the conduct of their businesses or for violations of any law, rule or regulation, any condition imposed in writing by the appropriate bank regulatory agency or any written agreement with the authority. Enforcement actions against us could include a federal conservatorship or receivership for the bank, the issuance of additional orders that could be judicially enforced, the imposition of civil monetary penalties, the issuance of directives to enter into a strategic transaction, whether by merger or otherwise, with a third-party, the termination of insurance of deposits, the issuance of removal and prohibition orders against institution-affiliated parties, and the enforcement of such actions through injunctions or restraining orders. In addition, if we were to grow beyond $10 billion in assets, we would be subject to enhanced CFPB examination and our compliance costs would increase.

We face a risk of noncompliance and enforcement action with the Bank Secrecy Act and other anti-money laundering statutes and regulations.

The Bank Secrecy Act, the USA PATRIOT Act of 2001, and other laws and regulations require financial institutions, among other duties, to institute and maintain an effective anti-money laundering program and file suspicious activity and currency transaction reports as appropriate. The federal Financial Crimes Enforcement Network is authorized to impose significant civil money penalties for violations of those requirements and has engaged in coordinated enforcement efforts with the individual federal banking regulators, as well as the U.S. Department of Justice, Drug Enforcement Administration, and Internal Revenue Service. We are also subject to increased scrutiny of compliance with the rules enforced by the Office of Foreign Assets Control and compliance with the Foreign Corrupt Practices Act. If our policies, procedures and systems are deemed deficient, we would

be subject to liability, including fines and regulatory actions, which may include restrictions on our ability to pay dividends and the necessity to obtain regulatory approvals to proceed with certain aspects of our business plan. Failure to maintain and implement adequate programs to combat money laundering and terrorist financing could also have serious reputational consequences for us. Any of these results could materially and adversely affect our business, financial condition and results of operations.

Regulatory capital standards impose enhanced capital adequacy requirements on us.

Increased regulatory capital requirements (and the associated compliance costs), which have been adopted by federal banking regulators, impose additional capital requirements on our business. The administration of existing capital adequacy laws as well as adoption of new laws and regulations relating to capital adequacy, or more expansive or aggressive interpretations of existing laws and regulations, could have a material adverse effect on our business, liquidity, financial condition and results of operations and could substantially restrict our ability to pay dividends, repurchase any of our capital stock, or pay executive bonuses. In addition, increased regulatory capital requirements as well as our financial condition could require us to raise additional capital which would dilute our existing shareholders at the time of such capital issuance.

If we are unable to effectively manage the composition and risk of our investment securities portfolio, which we expect will continue to comprise a significant portion of our earning assets, our net interest income and net interest margin could be adversely affected.

Our primary sources of interest income include interest on loans and leases, as well as interest earned on investment securities. Interest earned on investment securities represented 19.3% of our interest income in the year ended December 31, 2018, as compared to 20.7% of our interest income in the year ended December 31, 2017. Accordingly, effectively managing our investment securities portfolio to generate interest income while managing the composition and risks associated with that portfolio, including the mix of government agency and non-agency securities, remains important. If we are unable to effectively manage our investment securities portfolio or if the interest income generated by our investment securities portfolio declines, our net interest income and net interest margin could be adversely affected.

The soundness of other financial institutions could adversely affect us.

Our ability to engage in routine funding transactions could be adversely affected by the actions and commercial soundness of other financial institutions. Defaults by, or even rumors or questions about, one or more financial services institutions, or the financial services industry generally, have led to market-wide liquidity problems and could lead to losses or defaults by us or by other institutions. There is no assurance that any such losses would not materially and adversely affect our results of operations.

Our deposit customers may pursue alternatives to deposits at our bank or seek higher yielding deposits causing us to incur increased funding costs.

Checking and savings account balances and other forms of deposits can decrease when our deposit customers perceive alternative investments, such as the stock market or other non-depository investments, as providing superior expected returns or seek to spread their deposits over several banks to maximize FDIC insurance coverage. Furthermore, technology and other changes have made it more convenient for the bank's customers to transfer funds into alternative investments including products offered by other financial institutions or non-bank service providers. Additional increases in short-term interest rates could increase transfers of deposits to higher yielding deposits. Efforts and initiatives we undertake to retain and increase deposits, including deposit pricing, can increase our costs. When the bank's customers move money out of bank deposits in favor of alternative investments or into higher yielding deposits, or spread their accounts over several banks, we can lose a relatively inexpensive source of funds, thus increasing our funding costs.

The fiscal, monetary and regulatory policies of the federal government and its agencies could have a material adverse effect on our results of operations.

The FRB regulates the supply of money and credit in the U.S. Its policies determine in large part the cost of funds for lending and investing and the return earned on those loans and investments, both of which affect the net interest margin. It also can materially decrease the value of financial assets we hold, such as debt securities.

In an effort to stimulate the economy, the federal government and its agencies have taken various steps to keep interest rates at extremely low levels. Our net interest income and net interest margin may be negatively impacted by a prolonged low interest rate environment like we are currently experiencing as it may result in us holding lower yielding loans and securities on our balance sheet, particularly if we are unable to replace the maturing higher yielding assets with similar higher yielding assets.

Changes in the slope of the yield curve, which represents the spread between short-term and long-term interest rates, could also reduce our net interest income and net interest margin. Historically, the yield curve is upward sloping, meaning short-term rates are lower than long-term rates. When the yield curve flattens, as is the case in the current interest rate environment, our net interest income and net interest margin could decrease as our cost of funds increases relative to the yield we can earn on our assets.

The FRB has increased interest rates seven times over the last two years. Should the FRB continue to raise interest rates significantly and rapidly, there is potential for decreased demand for our loan products, an increase in our cost of funds, and curtailment of the current economic recovery.

Changes in FRB policies and our regulatory environment are beyond our control, and we are unable to predict what changes may occur or the manner in which any future changes may affect our business, financial condition and results of operation.

We may be adversely impacted by the transition from LIBOR as a reference rate.

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

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

We rely on dividends from our subsidiary for most of our revenue.

Because we are a holding company with no significant operations other than our bank, we depend upon dividends from our bank for a substantial portion of our revenues and our liquidity.

Hawaii law only permits the bank to pay dividends out of retained earnings as defined under Hawaii banking law ("Statutory Retained Earnings"), which differs from GAAP retained earnings. As of December 31, 2018, the bank had Statutory Retained Earnings of $46.6 million. In addition, regulatory authorities could limit the ability of the bank to pay dividends to CPF. The inability to receive dividends from the bank could have a material adverse effect on our financial condition, results of operations and prospects.

Our ability to pay cash dividends to our shareholders is subject to restrictions under federal and Hawaii law, including restrictions imposed by the FRB and covenants set forth in various agreements we are a party to, including covenants set forth in our subordinated debentures. We cannot provide any assurance that we will continue to pay dividends.

The occurrence of fraudulent activity, breaches or failures of our information security controls or cybersecurity-related incidents could have a material adverse effect on our business, financial condition and results of operations.

As a financial institution, we are susceptible to fraudulent activity, information security breaches and cybersecurity-related incidents that may be committed against us, our customers or our business partners, which may result in financial losses or increased costs to us or, our customers or our business partners, disclosure or misuse of our information or our client information, misappropriation of assets, privacy breaches against our clients, litigation, or damage to our reputation. Such fraudulent activity may take many forms, including check fraud, electronic fraud, wire fraud, phishing, social engineering and other dishonest acts. Information security breaches and cybersecurity-related incidents may include fraudulent or unauthorized access to systems used by us, our vendors, or our clients, denial or degradation of service attacks, and malware or other cyber-attacks. In recent periods, there continues to be a rise in electronic fraudulent activity, security breaches and cyber-attacks within the financial services industry, especially in the commercial banking sector due to cyber criminals targeting commercial bank accounts. Consistent with industry trends, we have also experienced an increase in attempted electronic fraudulent activity, security breaches and cybersecurity-related incidents in recent periods. Moreover, in recent periods, several large

corporations, including financial institutions and retail companies, have suffered major data breaches, in some cases exposing not only confidential and proprietary corporate information, but also sensitive financial and other personal information of their customers and employees and subjecting them to potential fraudulent activity. Some of our clients may have been affected by these breaches, which increase their risks of identity theft, credit card fraud and other fraudulent activity that could involve their accounts with us.

Information pertaining to us and our clients is maintained, and transactions are executed, on the networks and systems of us, our clients and certain of our third-party partners, such as our online banking or reporting systems. The secure maintenance and transmission of confidential information, as well as execution of transactions over these systems, are essential to protect us and our clients against fraud and security breaches and to maintain our clients' confidence. Breaches of information security also may occur, and in infrequent cases have occurred, through intentional or unintentional acts by those having access to our systems or our clients' or counterparties' confidential information, including employees. In addition, increases in criminal activity levels and sophistication, advances in computer capabilities, new discoveries, vulnerabilities in third-party technologies (including browsers and operating systems) or other developments could result in a compromise or breach of the technology, processes and controls that we use to prevent fraudulent transactions and to protect data about us, our clients and underlying transactions, as well as the technology used by our clients to access our systems. Although we have developed, and continue to invest in, systems and processes that are designed to detect and prevent security breaches and cyber-attacks and periodically test our security, we may fail to anticipate or adequately mitigate breaches of security that could result in: losses to us or our clients; our loss of business and/or clients; damage to our reputation; the incurrence of additional expenses; disruption to our business; our inability to grow our online services or other businesses; additional regulatory scrutiny or penalties; or our exposure to civil litigation and possible financial liability — any of which could have a material adverse effect on our business, financial condition and results of operations.

More generally, publicized information concerning security and cyber-related problems could inhibit the use or growth of electronic or web-based applications or solutions as a means of conducting commercial transactions. Such publicity may also cause damage to our reputation as a financial institution. As a result, our business, financial condition and results of operations could be adversely affected.

We continually encounter technological change.

The financial services industry is continually undergoing rapid technological change with frequent introductions of new technology-driven products and services. The effective use of technology increases efficiency and enables financial institutions to better serve customers and to reduce costs. Our future success depends, in part, upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy customer demands, as well as to create additional efficiencies in our operations. Many of our competitors have substantially greater resources to invest in technological improvements. We may not be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers. In addition, there are a limited number of qualified persons in our local marketplace with the knowledge and experience required to effectively maintain our information technology systems and implement our technology initiatives. Failure to successfully attract and retain qualified personnel, or keep pace with technological change affecting the financial services industry could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

Financial services companies depend on the accuracy and completeness of information about customers and counterparties.

In deciding whether to extend credit or enter into other transactions, we may rely on information furnished by or on behalf of customers and counterparties, including financial statements, credit reports and other financial information. We may also rely on representations of those customers, counterparties or other third parties, such as independent auditors, as to the accuracy and completeness of that information. Reliance on inaccurate or misleading financial statements, credit reports or other financial information could have a material adverse impact on our business and, in turn, our financial condition and results of operations.

We are subject to various legal claims and litigation.

From time to time, customers, employees and others whom we do business with, or are regulated by, as well as our shareholders, can make claims and take legal action against us. Regardless of whether these claims and legal actions are founded or unfounded, if such claims and legal actions are not resolved in a manner favorable to us, they may result in significant financial liability and/or adversely affect the market perception of us and our products and services, as well as impact customer demand for our products and services. Any financial liability or reputational damage could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations. Even if these claims and legal actions do not result in a financial liability or reputational damage, defending these

claims and actions have resulted in, and will continue to result in, increased legal and professional services costs, which adds to our noninterest expense and negatively impacts our operating results.

We operate in a highly competitive industry and market area.

We face substantial competition in all areas of our operations from a variety of different competitors, many of which are larger and may have more financial resources. Such competitors primarily include national, regional and community banks within the various markets we operate. Additionally, various out of state banks conduct business in the market areas in which we currently operate. We also face competition from many other types of financial institutions, including, without limitation, savings banks, credit unions, finance companies, financial service providers, including mortgage providers and brokers, operating via the internet and other technology platforms, brokerage firms, insurance companies, factoring companies and other financial intermediaries.

The financial services industry could become even more competitive as a result of legislative, regulatory and technological changes and continued consolidation. Banks, securities firms and insurance companies can merge under the umbrella of a financial holding company, which can offer virtually any type of financial service, including banking, securities underwriting, insurance (both agency and underwriting) and merchant banking. Also, technology has lowered barriers to entry and made it possible for non-banks to offer products and services traditionally provided by banks, such as automatic transfer and automatic payment systems. Many of our competitors have fewer regulatory constraints and may have lower cost structures. Additionally, due to their size, many competitors may be able to achieve economies of scale and, as a result, may offer a broader range of products and services as well as better pricing for those products and services than we can.

Our ability to compete successfully depends on a number of factors, including, among other things:

- the ability to develop, maintain and build upon long-term customer relationships based on top quality service, high ethical standards and safe, sound assets;
- the ability to expand our market position;
- the scope, relevance and pricing of products and services offered to meet customer needs and demands;
- the rate at which we introduce new products and services relative to our competitors;
- customer satisfaction with our level of service; and
- industry and general economic trends.

Failure to perform in any of these areas could significantly weaken our competitive position, which could adversely affect our growth and profitability, which, in turn, could have a material adverse effect on our financial condition and results of operations.

In addition, the soundness of our financial condition may also affect our competitiveness. Customers may decide not to do business with the bank due to its financial condition.

We are dependent on key personnel and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Competition for qualified employees and personnel in the banking industry is intense and there is a limited number of qualified persons with knowledge of, and experience in, the regional banking industry, especially in the Hawaii market. The process of recruiting personnel with the combination of skills and attributes required to carry out our strategies is often lengthy. Our success depends to a significant degree upon our ability to attract and retain qualified management, loan origination, finance, administrative, marketing, and technical personnel, and upon the continued contributions of our management and personnel. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our Chief Executive Officer, our President, our Chief Financial Officer, our Chief Information Officer, our Chief Credit Officer, and certain other employees.

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

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

Our business could be adversely affected by unfavorable actions from rating agencies.

Ratings assigned by ratings agencies to us, our affiliates or our securities may impact the decision of certain customers, in particular, institutions, to do business with us. A rating downgrade or a negative rating could adversely affect our deposits and our business relationships.

Failure to maintain effective internal control over financial reporting or disclosure controls and procedures could adversely affect our ability to report our financial condition and results of operations accurately and on a timely basis.

A failure to maintain effective internal control over financial reporting or disclosure controls and procedures could adversely affect our ability to report our financial results accurately and on a timely basis, which could result in a loss of investor confidence in our financial reporting or adversely affect our access to sources of liquidity. Furthermore, because of the inherent limitations of any system of internal control over financial reporting, including the possibility of human error, the circumvention or overriding of controls and fraud, even effective internal controls may not prevent or detect all misstatements. Frequent or rapid changes in procedures, methodologies, systems, personnel and technology exacerbate the challenge of developing and maintaining a system of internal controls and can increase the cost and level of effort to develop and maintain such systems.

Natural disasters and other external events could have a material adverse affect on our financial condition and results of operations.

Our branch offices as well as a substantial majority of our loan portfolio is in the state of Hawaii. As a result, natural disasters and other severe weather occurrences such as tsunamis, volcanic eruptions (such as the recent eruption of Mount Kilauea), hurricanes and earthquakes and other adverse external events, could have a significant effect on our ability to conduct our business and adversely affect the tourism and visitor industry in the state of Hawaii. Such events could affect the ability of our borrowers to repay their outstanding loans, impair the value of collateral securing our loans, cause significant property damage, result in loss of revenue, adversely impact our deposit base and/or cause us to incur additional expenses. Accordingly, the occurrence of any such natural disasters or severe weather events could have a material adverse effect on our business, which, in turn, could adversely affect our financial condition and results of operations.

Risk Factors Related to Our Securities

The market price of our common stock could decline.

The trading price of our common stock may fluctuate widely as a result of a number of factors, many of which are outside our control. In addition, the stock market is subject to fluctuations in the share prices and trading volumes that affect the market prices of the shares of many companies. These broad market fluctuations could adversely affect the market price of our common stock. Among the factors that could affect our stock price are:

- failure to comply with all of the requirements of any governmental orders or agreements we may become subject to and the possibility of resulting action by the regulators;
- deterioration of asset quality;
- the incurrence of losses;
- actual or anticipated quarterly fluctuations in our operating results and financial condition;

- changes in revenue or earnings/losses estimates or publication of research reports and recommendations by financial analysts;
- failure to meet analysts' revenue or earnings/losses estimates;
- speculation in the press or investment community;
- strategic actions by us or our competitors, such as mergers, acquisitions, restructurings, or public offerings;
- additions or departures of key personnel;
- actions by institutional shareholders;
- fluctuations in the stock price and operating results of our competitors;
- future sales of other equity or debt securities, including our common stock;
- general market conditions and, in particular, developments related to market conditions for the financial services industry;
- proposed or adopted regulatory changes or developments;
- breaches in our security systems and loss of customer data;
- anticipated or pending investigations, proceedings or litigation that involve or affect us; or
- domestic and international economic factors unrelated to our performance.

The stock market and, in particular, the market for financial institution stocks, have experienced significant volatility over the past few years. In addition, the trading volume in our common stock may fluctuate more than usual and cause significant price variations to occur. Accordingly, the common stock that you purchase may trade at a price lower than that at which they were purchased. Volatility in the market price of our common stock may prevent individual shareholders from being able to sell their shares when they want or at prices they find attractive.

A significant decline in our stock price could result in substantial losses for shareholders and could lead to costly and disruptive securities litigation.

Anti-takeover provisions in our restated articles of incorporation and bylaws and applicable federal and state law may limit the ability of another party to acquire us, which could cause our stock price to decline.

Various provisions of our restated articles of incorporation and bylaws and certain other actions we have taken could delay or prevent a third-party from acquiring us, even if doing so might be beneficial to our shareholders. These include, among other things, the authorization to issue "blank check" preferred stock by action of the Board of Directors acting alone, thus without obtaining shareholder approval. In addition, applicable provisions of federal and state law require regulatory approval in connection with certain acquisitions of our common stock and supermajority voting provisions in connection with certain transactions. In particular, both federal and state law limit the acquisition of ownership of, generally, 10% or more of our common stock without providing prior notice to the regulatory agencies and obtaining prior regulatory approval or nonobjection or being able to rely on an exemption from such acquisition. See the "Supervision and Regulation" section. Collectively, these provisions of our restated articles of incorporation and bylaws and applicable federal and state law may prevent a merger or acquisition that would be attractive to shareholders and could limit the price investors would be willing to pay in the future for our common stock.

Our common stock is equity and therefore is subordinate to our subsidiaries' indebtedness and preferred stock.

Our common stock constitutes equity interests and does not constitute indebtedness. As such, common stock will rank junior to all current and future indebtedness and other non-equity claims on us with respect to assets available to satisfy claims against us, including in the event of our liquidation. We may, and the bank and our other subsidiaries may also, incur additional indebtedness from time to time and may increase our aggregate level of outstanding indebtedness. As of December 31, 2018, we had $70.0 million in face amount of trust preferred securities outstanding and accrued and unpaid dividends thereon of $0.4

million. We also had short-term FHLB borrowings of $197.0 million and long-term FHLB borrowings of $50.0 million as of December 31, 2018. Additionally, holders of common stock are subject to the prior dividend and liquidation rights of any holders of our preferred stock that may be outstanding from time to time. The Board of Directors is authorized to cause us to issue additional classes or series of preferred stock without any action on the part of our stockholders. If we issue preferred shares in the future that have a preference over our common stock with respect to the payment of dividends or upon liquidation, or if we issue preferred shares with voting rights that dilute the voting power of the common stock, then the rights of holders of our common stock or the market price of our common stock could be adversely affected.

There is a limited trading market for our common stock and as a result, you may not be able to resell your shares at or above the price you pay for them at the time you otherwise may desire.

Although our common stock is listed for trading on the NYSE, the volume of trading in our common shares is lower than many other companies listed on the NYSE. A public trading market with depth, liquidity and orderliness depends on the presence in the market of willing buyers and sellers of our common shares at any given time. This presence depends on the individual decisions of investors and general economic and market conditions over which we have no control. As a result, you may not be able to resell your common stock at or above the price you pay or at the time(s) you otherwise may desire.

Our common stock is not insured and you could lose the value of your entire investment.

An investment in our common stock is not a deposit and is not insured against loss by the government.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

Certifications

We have filed the required certifications under Section 302 of the Sarbanes-Oxley Act of 2002 as Exhibits 31.1 and 31.2 to this annual report on Form 10-K for the fiscal year ended December 31, 2018. Last year, we submitted to the NYSE on May 1, 2018 our annual CEO certification regarding the Company's compliance with the NYSE's corporate governance listing standards. This year, we intend to submit to the NYSE our annual CEO certification within 30 days of the Company's annual meeting of shareholders, which is scheduled for April 26, 2019.

ITEM 2. PROPERTIES

We hold title to the land and building in which our Main branch office and headquarters, Hilo branch office, Kailua-Kona branch office, Pearl City branch office and certain operations offices are located. We also hold title to a portion of the land on which our operations center is located. The remaining portion of the land where our operations center is located is leased, as are all remaining branch and support office facilities. We also own four floors of a commercial office condominium in downtown Honolulu where certain bank training classes are held and residential mortgage sales and operations are located.

We occupy or hold leases for approximately 40 other properties including office space for our remaining branches. These leases expire on various dates through 2045 and generally contain renewal options for periods ranging from 5 to 15 years. For additional information relating to lease rental expense and commitments as of December 31, 2018, see Note 19 - Operating Leases to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data."

ITEM 3. LEGAL PROCEEDINGS

Certain claims and lawsuits have been filed or are pending against us arising in the ordinary course of business. In the opinion of management, all such matters are of a nature that, if disposed of unfavorably, would not have a material adverse effect on our consolidated results of operations or financial position.

ITEM 4. MINE SAFETY DISCLOSURES

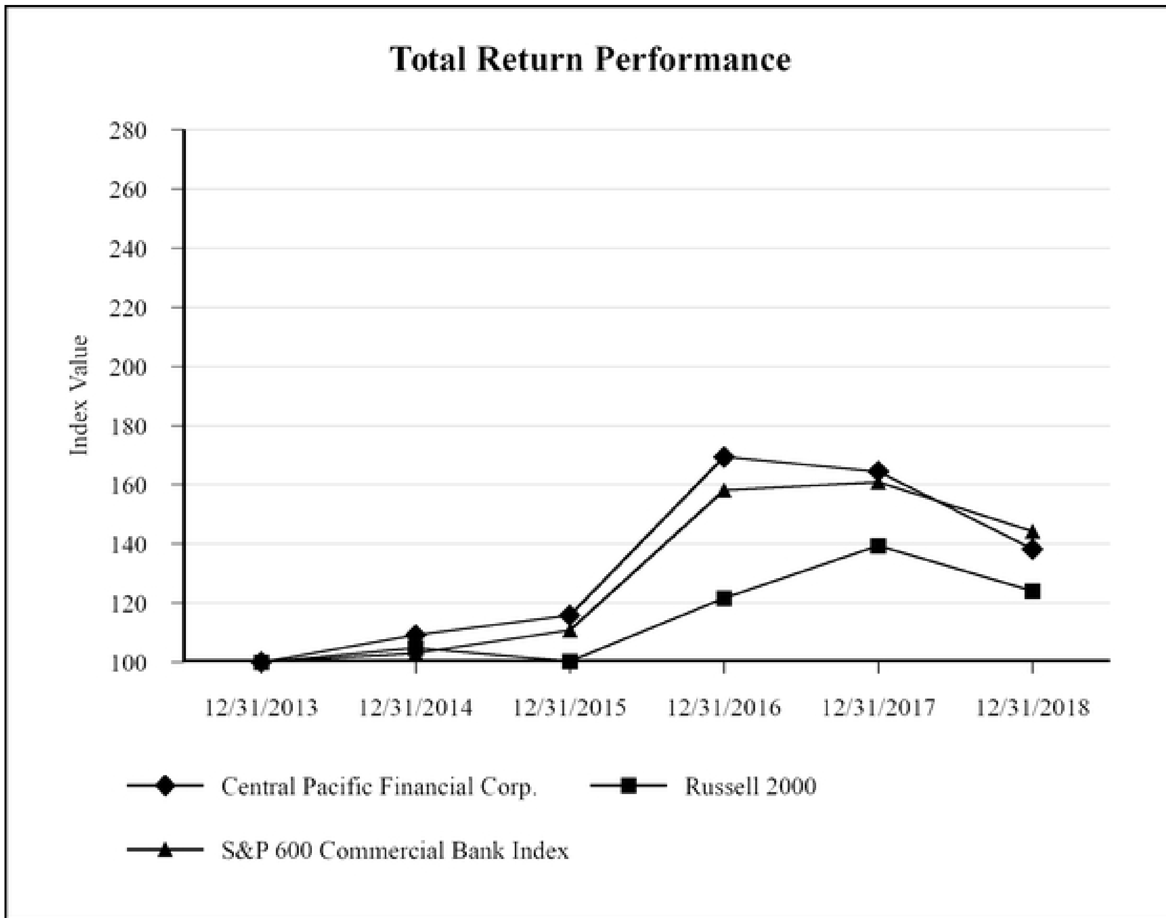
Not applicable

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on the NYSE under the ticker symbol "CPF." Set forth below is a line graph comparing the cumulative total stockholder return on the Company's common stock, based on the market price of the common stock and assuming reinvestment of dividends, with the Russell 2000 Index and the Standard and Poor's ("S&P") SmallCap 600 Commercial Bank Index for the five year period commencing December 31, 2013 and ending December 31, 2018. The graph assumes the investment of $100 on December 31, 2013.

Indexed Total Annual Return
(as of **December 31, 2018**)



	December 31,					
Index	**2013**	**2014**	**2015**	**2016**	**2017**	**2018**
Central Pacific Financial Corp.	$ 100.00	$ 109.14	$ 115.84	$ 169.41	$ 164.51	$ 138.20
Russell 2000	100.00	104.89	100.26	121.63	139.44	124.09
S&P 600 Commercial Bank Index	100.00	103.08	110.82	158.20	160.85	144.30

As of January 31, 2019, there were 3,451 shareholders of record, excluding individuals and institutions for which shares were held in the names of nominees and brokerage firms.

Dividends

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

Under the terms of our trust preferred securities, our ability to pay dividends with respect to common stock would be restricted if our obligations under our trust preferred securities were not current. Our obligations on our outstanding trust preferred securities are current as of December 31, 2018.

Additionally, our ability to pay dividends depends on our ability to obtain dividends from our bank. As a Hawaii state-chartered bank, the bank may only pay dividends to the extent it has retained earnings as defined under Hawaii banking law ("Statutory Retained Earnings"), which differs from GAAP retained earnings. As of December 31, 2018, the bank had Statutory Retained Earnings of $46.6 million. In addition, the bank's regulators could impose limitations or conditions on the bank's ability to pay dividends to the Company.

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

Issuer Purchases of Equity Securities

In January 2017, our Board of Directors authorized the repurchase of up to $30.0 million of the Company's common stock from time to time on the open market or in privately negotiated transactions, pursuant to a newly authorized share repurchase program (the "2017 Repurchase Plan"). The 2017 Repurchase Plan replaced and superseded in its entirety the previous share repurchase program.

In November 2017, the Board of Directors authorized an increase in the 2017 Repurchase Plan authority by an additional $50.0 million (known henceforth as the "Repurchase Plan"). We cannot provide any assurance that we will be able to repurchase any of our common stock. In addition, our ability to repurchase common stock may be restricted by applicable federal or Hawaii law or by our regulators.

During the quarter ended December 31, 2018, 305,867 shares of common stock, at a cost of $8.1 million, excluding fees and expenses, were repurchased under the Repurchase Plan. A total of $20.7 million remained available for repurchase under the Repurchase Plan at December 31, 2018. There is no expiration date on the Repurchase Plan.

	Issuer Purchases of Equity Securities					
Period	**Total Number of Shares Purchased**	**Average Price Paid per Share**	**Total Number of Shares Purchased as Part of Publicly Announced Programs**	**Maximum Number of Shares that May Yet Be Purchased Under the Program**	**Dollar Value of Shares Purchased as Part of Publicly Announced Programs**	**Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program**
October 1-31	111,367	$ 25.99	111,367	—	$ 2,894,887	$ 25,834,354
November 1-30	94,000	27.70	94,000	—	2,603,545	23,230,809
December 1-31	100,500	25.50	100,500	—	2,562,293	20,668,516
Total	305,867	26.35	305,867	—	$ 8,060,725	20,668,516

During the entire year of 2018, 1,155,157 shares of common stock, at a cost of $32.8 million or an average cost per share of $28.42, were repurchased under the Repurchase Plan.

Information relating to compensation plans under which equity securities of the Registrant are authorized for issuance is set forth under "Part III, Item 12—Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters."

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following table sets forth selected financial information for each of the years in the five-year period ended December 31, 2018. This information is not necessarily indicative of results of future operations and should be read in conjunction with "Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Consolidated Financial Statements and related Notes contained in "Part II, Item 8. Financial Statements and Supplementary Data." Significant items affecting the comparability of the information presented in this table follows this presentation.

	Year Ended December 31,				
Selected Financial Data	**2018**	**2017**	**2016**	**2015**	**2014**
	(Dollars in thousands, except per share data)				
Statement of Income Data:					
Total interest income	$ 198,294	$ 182,562	$ 167,139	$ 156,035	$ 149,809
Total interest expense	25,296	14,859	9,189	6,507	6,391
Net interest income	172,998	167,703	157,950	149,528	143,418
Provision (credit) for loan and lease losses	(1,124)	(2,674)	(5,517)	(15,671)	(6,414)
Net interest income after provision for loan and lease losses	174,122	170,377	163,467	165,199	149,832
Other operating income	38,804	36,496	42,316	34,799	41,166
Other operating expense (1)	134,682	131,073	132,518	125,964	128,793
Income before income taxes	78,244	75,800	73,265	74,034	62,205
Income tax expense (1)	18,758	34,596	26,273	28,166	21,752
Net income	59,486	41,204	46,992	45,868	40,453
Balance Sheet Data (as of Year-End):					
Interest-bearing deposits in other banks	$ 21,617	$ 6,975	$ 9,069	$ 8,397	$ 13,691
Investment securities (2)	1,354,812	1,496,644	1,461,515	1,520,172	1,467,305
Loans and leases	4,078,366	3,770,615	3,524,890	3,211,532	2,932,198
Allowance for loan and lease losses	47,916	50,001	56,631	63,314	74,040
Mortgage servicing rights	15,596	15,843	15,779	17,797	19,668
Core deposit premium	—	2,006	4,680	7,355	10,029
Total assets	5,807,026	5,623,708	5,384,236	5,131,288	4,852,987
Core deposits (3)	4,015,942	3,991,234	3,713,567	3,582,178	3,306,133
Total deposits	4,946,490	4,956,354	4,608,201	4,433,439	4,110,300
Long-term debt	122,166	92,785	92,785	92,785	92,785
Total shareholders' equity	491,725	500,011	504,650	494,614	568,041
Per Share Data:					
Basic earnings per common share	$ 2.02	$ 1.36	$ 1.52	$ 1.42	$ 1.08
Diluted earnings per common share	2.01	1.34	1.50	1.40	1.07
Cash dividends declared per common share	0.82	0.70	0.60	0.82	0.36
Book value per common share	16.97	16.65	16.39	16.06	16.12
Diluted weighted average shares outstanding (in thousands)	29,610	30,638	31,225	32,651	37,937
Financial Ratios:					
Return on average assets	1.05%	0.75%	0.90%	0.92%	0.85%
Return on average shareholders' equity	12.22	8.03	9.16	8.91	6.80
Net income to average tangible shareholders' equity	12.24	8.08	9.27	9.06	6.93
Average shareholders' equity to average assets	8.56	9.32	9.78	10.37	12.50
Dividend payout ratio	40.80	52.24	40.00	58.57	33.64
Efficiency ratio (1)	63.59	64.19	66.17	68.34	69.77
Net interest margin (4)	3.22	3.28	3.27	3.30	3.32
Regulatory Capital Ratios:					
Leverage capital	9.9%	10.4%	10.6%	10.7%	12.0%

Tier 1 risk-based capital	13.5	14.7	14.2	14.4	17.0
Total risk-based capital	14.7	15.9	15.5	15.7	18.2
CET1 risk-based capital	11.9	12.4	12.3	12.8	N/A

	Year Ended December 31,				
Selected Financial Data	**2018**	**2017**	**2016**	**2015**	**2014**
	(Dollars in thousands, except per share data)				
Asset Quality:					
Net loan charge-offs (recoveries) to average loans and leases	0.02%	0.11%	0.03%	(0.16)%	0.12%
Nonaccrual loans to total loans and leases (5)	0.06	0.07	0.24	0.44	1.33
Allowance for loan and lease losses to total loans and leases	1.17	1.33	1.61	1.97	2.53
Allowance for loan and lease losses to nonaccrual loans (5)	2,062.68	1,801.84	674.50	443.75	189.42

(1) The efficiency ratio is a non-GAAP financial measure which should be read and used in conjunction with the Company's GAAP financial information. Comparison of our efficiency ratio with those of other companies may not be possible because other companies may calculate the efficiency ratio differently. Our efficiency ratio is derived by dividing other operating expense by net operating revenue (net interest income plus other operating income). Prior period other operating expense, income tax expense and efficiency ratio have been revised to conform to current period, which reflects reclassifications related to the change in accounting policy for our investments in low-income housing tax credit partnerships referred to in Note 1 - Summary of Significant Accounting Policies. See Item 7 — Management's Discussion and Analysis of Financial Condition and Results of Operations —Table 5 - Reconciliation of Efficiency Ratio.
(2) Held-to-maturity securities at amortized cost, available-for-sale securities at fair value.
(3) Noninterest-bearing demand, interest-bearing demand and savings deposits, and time deposits under $100,000.
(4) Computed on a taxable-equivalent basis using a federal statutory tax rate of 21% for the year ended December 31, 2018 and 35% for the previous years.
(5) Nonaccrual loans exclude nonaccrual loans-held-for-sale, if any.

Five Year Performance Comparison

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

	Year Ended December 31,				
(Dollars in thousands)	**2018**	**2017**	**2016**	**2015**	**2014**
Provision (credit) for loan and lease losses	$ (1,124)	$ (2,674)	$ (5,517)	$ (15,671)	$ (6,414)
Other operating income:					
Mortgage banking income	7,315	6,962	8,069	7,254	8,980
Gain on sale of premises and equipment	—	—	3,537	—	—
Investment securities gains (losses)	(279)	(1,410)	—	(1,866)	240
Other operating expense:					
Share-based compensation (included in salaries and employee benefits)	3,787	3,266	3,094	4,181	6,101
Pension obligation settlement (included in salaries and employee benefits)	—	—	3,848	—	—
One-time reversal of an accrual for a former executive's retirement benefits that will not be paid (included in salaries and employee benefits)	—	—	—	(2,400)	—
Foreclosed asset expense	574	151	152	486	1,710
Charitable contributions (included in other)	635	593	660	2,559	565
FDIC insurance premium (included in other)	1,732	1,724	2,052	2,706	2,848
Provision (credit) for residential mortgage loan repurchase losses (included in other)	150	209	(387)	(1,352)	467
Branch consolidation and relocation costs (included in other)	—	—	737	—	1,336
Income tax expense (benefit)	18,758	34,596	26,273	28,166	21,752

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Introduction

We are a bank holding company that, through our banking subsidiary, Central Pacific Bank, offers full service commercial banking in the state of Hawaii.

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

- *Loans*: Our loans consist of commercial, financial and agricultural, commercial mortgage, and construction loans to small and medium-sized companies, business professionals, and real estate investors and developers, as well and residential mortgage, home equity and consumer loans to local homeowners and individuals. Our lending activities contribute to a key component of our revenues reported in interest income.

- *Deposits*: We offer a full range of deposit products and services including checking, savings and time deposits, cash management, and electronic banking services. We also maintain a broad branch and ATM network in the state of Hawaii. The interest paid on such deposits has a significant impact on our interest expense, an important factor in determining our earnings. In addition, fees and service charges on deposit accounts contribute to our revenues.

Additionally, we offer wealth management products and services, such as non-deposit investment products, annuities, insurance, investment management, asset custody and general consultation and planning services.

Executive Overview

In 2018 we continued to achieve key objectives for the Company.

- We recorded our eighth consecutive profitable year in 2018 with net income of $59.5 million, or $2.01 per diluted common share.

- We recorded increases in our return on average assets ("ROA") and return on average shareholders' equity ("ROE") ratios of 1.05% and 12.22%, respectively, in 2018, compared to ROA and ROE ratios of 0.75% and 8.03%, respectively, in 2017.

- We saw continued improvement in our asset quality as our nonperforming assets declined by $0.9 million to $2.7 million at December 31, 2018 from $3.6 million at December 31, 2017.

- As a result of the continued improvement in our credit risk profile and charge-off history, we were able to further reduce our allowance for loan and lease losses (the "Allowance"), which again resulted in a positive impact to earnings. Our total provision for loan and lease losses (the "Provision") was a credit of $1.1 million, compared to a credit of $2.7 million in 2017.

- With the healthy market conditions in Hawaii, together with our efforts to expand and strengthen customer relationships, we realized strong loan growth of $307.8 million, or 8.2%, as well as core deposit growth of $24.7 million, or 0.6% in 2018.

- Our capital position remained strong, supported by eight consecutive years of profitability and the improvements in our asset quality. With consistent profitability, we were able to increase our regular cash dividends paid from $0.70 per share in 2017 to $0.82 per share in 2018.

- In 2018, our strong capital position and consistent profitability also allowed us to execute on our stock repurchase program and repurchase 1,155,157 shares, or approximately 3.8% of outstanding shares as of December 31, 2017.

Basis of Presentation

Management's discussion and analysis of financial condition and results of operations should be read in conjunction with the accompanying consolidated financial statements under "Part II, Item 8. Financial Statements and Supplementary Data."

Business Environment

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

Following the solid performances of our leading economic indicators in 2017, Hawaii's general economic conditions continued to improve but at a slower pace in 2018. Tourism continues to be Hawaii's center of strength and its most significant economic driver. For the seventh consecutive year, Hawaii's strong visitor industry broke records in several key categories, including visitor arrivals and visitor spending. According to the Hawaii Tourism Authority ("HTA"), approximately 10.0 million total visitors arrived in the state in 2018. This was an increase of 5.9% from the previous record high of 9.4 million visitor arrivals in 2017. The HTA also reported that total spending by visitors increased to $17.82 billion in 2018, an increase of 6.8%, from the previous record high of $16.68 billion in 2017. According to the Hawaii Department of Business Economic Development and Tourism ("DBEDT"), total visitor arrivals and visitor spending are expected to increase by 1.8% and 4.2% in 2019, respectively.

The Department of Business, Economic Development and Tourism ("DBEDT") reported Hawaii's economy, as measured by the growth of real personal income and real gross state product, continued positive growth in 2018. DBEDT is expected to report real personal income and real gross state product growth of approximately 1.6% and 1.0%, respectively, for 2018 and projects a growth rate of 1.7% and 1.2%, respectively, for 2019.

Hawaii's labor market continues to be among the best in the nation. The Department of Labor and Industrial Relations reported that Hawaii's seasonally adjusted annual unemployment rate in December 2018, which was 2.5%, compared to 2.1% in December 2017. Hawaii's unemployment rate in December 2018 of 2.5%, which is among the lowest in the nation, remained below the national seasonally adjusted unemployment rate of 3.9%. DBEDT projects Hawaii's seasonally adjusted annual unemployment rate to be at 2.5% in 2019.

Real estate lending is a primary focus for us, including residential mortgage and commercial mortgage loans. As a result, we are dependent on the strength of Hawaii's real estate market. Home sales in Hawaii remained strong in 2018. The Oahu real estate market closed out 2018 with its eighth-straight year of appreciation, however, the number of sales for the year dropped. According to the Honolulu Board of Realtors, the median price for a single-family home on Oahu reached an all-time high of $812,500 in the month of September 2018. The median resale price for the year ended December 31, 2018 for single-family homes on Oahu was $790,000, representing an increase of 4.6% from the median resale price of $755,000 for the year ended December 31, 2017. The median resale price for condominiums on Oahu was $420,000 for the year ended December 31, 2018, representing an increase of 3.7% from the median resale price of $405,000 for the year ended December 31, 2017. Oahu unit sales volume, however, decreased by 7.7% for single-family homes and decreased by 2.5% for condominiums in 2018 from 2017. We believe the Hawaii real estate market will continue to remain strong in 2019, however, there can be no assurance that this will occur.

As we have seen in the past, our operating results are significantly impacted by the economy in Hawaii and the composition of our loan portfolio. Loan demand, deposit growth, Provision, asset quality, noninterest income and noninterest expense are all affected by changes in economic conditions. If the residential and commercial real estate markets we have exposure to deteriorate our results of operations would be negatively impacted. See the "Overview of Results of Operations—Concentrations of Credit Risk" section for a further discussion on how a deteriorating real estate market, combined with the elevated concentration risk within our portfolio, could have a significant negative impact on our asset quality and credit losses.

In late 2008, the Federal Reserve lowered the target Federal Funds range to 0%-0.25%. In an attempt to help the overall economy, the FRB has kept interest rates low through its targeted Fed Funds rate until the recession was safely over. In recent years, the Federal Reserve has begun raising the target Federal Funds range. During 2017, the Federal Reserve increased the Federal Funds range three times, each time by 25 basis points, to 1.25%-1.50% as of December 31, 2017. During 2018, the Federal Reserve increased the Federal Funds range four times, each by 25 basis points to 2.25%-2.50% as of December 31, 2018.

As the Federal Reserve increases the Federal Funds range, overall interest rates will likely rise, which may negatively impact the U.S. economic recovery. Further, changes in monetary policy, including changes in interest rates, could influence, among other things, (i) the amount of interest we receive on loans and securities, (ii) the amount of interest we pay on deposits and borrowings, (iii) our ability to originate loans and obtain deposits, and (iv) the fair value of our assets and liabilities.

Critical Accounting Policies and Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America ("GAAP") requires that management make 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 is management's estimate of incurred credit losses inherent in our loan and lease portfolio at the balance sheet date. We maintain our Allowance at an amount we expect to be sufficient to absorb probable losses incurred in our loan and lease portfolio.

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

Specific Reserve

Individually impaired loans in all loan categories are evaluated using one of three valuation methods as prescribed under Accounting Standards Codification ("ASC") 310-10, *"Fair Value of Collateral, Observable Market Price, or Cash Flow"*. A loan is generally evaluated for impairment on an individual basis if it meets one or more of the following characteristics: risk-rated as substandard, doubtful or loss, loans on nonaccrual status, troubled debt restructures, or any loan deemed prudent by management to so analyze. If the valuation of the impaired loan is less than the recorded investment in the loan, the deficiency will be charged off against the Allowance or, alternatively, a specific reserve will be established and included in the overall Allowance balance. The Company did not record a specific reserve as of December 31, 2018 and December 31, 2017.

General Allowance

In determining the general allowance component of the Allowance, the Company utilizes a comprehensive approach to segment the loan portfolio into homogeneous groups. The methodology segments the portfolio generally by FDIC Call Report codes. In the second quarter of 2017, an additional segment was added for auto dealer purchased loans. In the third quarter of 2018, another segment was broken out for multifamily commercial real estate loans. This results in eleven segments, and is consistent with general industry practice. For the purpose of determining general allowance loss factors, loss experience is derived from a migration analysis, with the exception of national syndicated loans and auto dealer purchased loans where an average historical loss rate is applied due to limited historical loss experience. The key inputs to run a migration analysis are the length of the migration period, the dates for the migration periods to start and the number of migration periods used for the analysis. For each migration period, the analysis will determine the outstanding balance in each segment and/or sub-segment at the start of each period. These loans will then be followed for the length of the migration period to identify the amount of associated charge-offs and recoveries. A loss rate for each migration period is calculated using the formula 'net charge-offs over the period divided by beginning loan balance'. The Allowance methodology applies a look back period to January 1, 2010. The Company extends its look back period with each additional quarter passing. As of December 31, 2018, the look back period was nine years.

Qualitative Adjustments

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

In recognizing that current and relevant environmental (economic, market or other) conditions that can affect repayment may not yet be fully reflected in historical loss experience, qualitative adjustments are applied to factor in current loan portfolio and

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

Overview of Results of Operations

2018 vs. 2017 Comparison

In 2018, we recognized net income of $59.5 million, or $2.01 per diluted common share, compared to net income of $41.2 million, or $1.34 per diluted common share, in 2017.

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

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

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

Other operating income increased by $2.3 million from 2017 to 2018. The increase in other operating income was primarily due to net losses on sales of investment securities of $1.4 million recognized in 2017, primarily attributable to the investment portfolio repositioning completed in 2017, compared to net losses on sales of investment securities of $0.3 million recognized in 2018. In addition, in 2018 we recognized higher commissions and fees on investment services of $1.2 million (included in other service charges and fees), higher income from fiduciary activities of $0.6 million, higher mortgage banking income of $0.4 million and higher fees on foreign exchange of $0.4 million. The higher mortgage banking income was primarily due to lower amortization of mortgage servicing rights of $0.4 million. These increases were partially offset by lower income from bank-owned life insurance of $1.3 million and lower equity in earnings of unconsolidated subsidiaries of $0.4 million. The lower income from bank-owned life insurance was primarily attributable to death benefit income of $1.1 million recognized in 2017 compared to $0.5 million recognized in 2018, combined with the decline in the stock market in 2018.

Other operating expense increased by $3.6 million, primarily due to the increase in salaries and employee benefits of $3.1 million, higher ATM and debit card expenses of $0.7 million, higher computer software expense of $0.6 million and higher equipment expense of $0.5 million. The increase in salaries and employee benefits was primarily attributable to increases in the Company's starting pay rate effective January 1, 2018, combined with merit salary increases effective in the second quarter of 2018. During the fourth quarter of 2018, the Company increased its starting pay rate for the second time in a year, effective December 1, 2018. These increases were partially offset by lower amortization of core deposit premium of $0.7 million, lower entertainment and promotions expense of $0.6 million and a credit to the reserve for unfunded commitments of $0.4 million (included in other).

Our ROA and ROE for 2018 was 1.05% and 12.22%, respectively, compared to 0.75% and 8.03%, respectively, in 2017. Our ROA and ROE in 2017 was negatively impacted by the aforementioned one-time non-cash charge of $7.4 million to income tax expense related to the estimated impact of Tax Reform on our DTA.

2017 vs. 2016 Comparison

In 2017, we recognized net income of $41.2 million, or $1.34 per diluted common share, compared to net income of $47.0 million, or $1.50 per diluted common share, in 2016.

We recorded a credit to the provision for loan and lease losses of $2.7 million in 2017, compared to a credit of $5.5 million in 2016.

Net interest income increased by $9.8 million from 2016 to 2017, primarily due to a significant increase in average loans and leases and taxable investment securities, combined with increases in average yields earned on the loans and leases and taxable investment securities portfolios. Partially offsetting the increase was the significant increase in rates paid on time deposits $100,000 and over.

Other operating income decreased by $5.8 million from 2016 to 2017. The decrease in other operating income was primarily due to a $3.5 million gain on the sale of the Company's fee interest in a former branch location recognized in 2016, combined with net losses on sales of investment securities of $1.4 million recognized in 2017. The investment securities losses were primarily attributable to the investment portfolio repositioning completed in 2017. In addition, in 2017 we recorded lower mortgage banking income of $1.1 million and lower income recovered on loans previously charged-off of $0.6 million compared to 2016. The lower mortgage banking income was primarily due to lower net gains on sales of residential mortgage loans of $3.6 million, partially offset by lower amortization of mortgage servicing rights of $2.8 million compared to 2016. These decreases were partially offset by higher income from bank-owned life insurance of $0.7 million, primarily attributable to death benefit income, and higher service charges on deposit accounts of $0.6 million compared to 2016.

Other operating expense decreased by $1.4 million, primarily due to decreases in salaries and employee benefits of $1.2 million, net occupancy expense of $0.5 million, and decreases in FDIC insurance assessment, amortization of investments in low-income housing tax partnerships, and computer software expenses of $0.3 million each compared to 2016. In addition, the Company recorded branch consolidation and relocation costs of $0.7 million in 2016. The lower salaries and employee benefits was primarily due to lower pension expense of $4.1 million in 2017, partially offset by $0.8 million in special, one-time bonuses given to all employees, with the exception of executives on its managing committee in the fourth quarter of 2017. In the fourth quarter of 2016, the Company executed a defined benefit pension plan de-risking strategy whereby the Company purchased non-participating annuity contracts to settle the pension obligation for a portion of its plan participants. This resulted in the immediate recognition of $3.8 million in net actuarial losses. In the fourth quarter of 2016, the Company also recognized a $0.7 million charge related to the early termination of a lease (included in branch consolidated and relocation costs). These decreases were partially offset by increases in legal and professional services of $0.9 million, provision for residential mortgage loan repurchase losses of $0.6 million, entertainment and promotions of $0.6 million, and equipment expenses of $0.4 million.

Income tax expense increased by $8.3 million from 2016, primarily due the aforementioned estimated one-time, non-cash charge to income tax expense of $7.4 million due to the revaluation of the Company's net deferred tax assets resulting from the reduction in the corporate Federal income tax rate in connection with Tax Reform.

Our ROA and ROE for 2017 was 0.75% and 8.03%, respectively, compared to 0.90% and 9.16%, respectively, in 2016.

Net Interest Income

The following table sets forth information concerning average interest-earning assets and interest-bearing liabilities and the yields and rates thereon. Net interest income, when expressed as a percentage of average interest-earning assets, is referred to as "net interest margin." Interest income, which includes loan fees and resultant yield information, is expressed on a taxable-equivalent basis using a federal statutory tax rate of 21% for the year ended December 31, 2018 and 35% for the years ended December 31, 2017 and December 31, 2016. Table 2 presents an analysis of changes in components of net interest income between years. For each category of interest-earning assets and interest-bearing liabilities, information is provided on changes attributable to: (i) changes in volume and (ii) changes in rates. The change in volume is calculated as change in average balance, multiplied by prior period average yield/rate. The change in rate is calculated as change in average yield/rate, multiplied by current period volume. The change in interest income not solely due to change in volume or change in rate has been allocated proportionately to change in volume and change in average yield/rate.

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

	2018			2017			2016		
	Average Balance	Average Yield/ Rate	Amount of Interest	Average Balance	Average Yield/ Rate	Amount of Interest	Average Balance	Average Yield/ Rate	Amount of Interest
				(Dollars in thousands)					
Assets									
Interest-earning assets:									
Interest-bearing deposits in other financial institutions	$ 20,104	1.81%	$ 365	$ 33,012	1.08%	$ 356	$ 13,143	0.51%	$ 67
Investment securities, excluding valuation allowance:									
Taxable (1)	1,304,523	2.65	34,562	1,351,436	2.51	33,982	1,307,946	2.36	30,890
Tax-exempt (1)	163,610	2.86	4,678	169,318	3.52	5,960	173,062	3.53	6,116
Total investment securities	1,468,133	2.67	39,240	1,520,754	2.63	39,942	1,481,008	2.50	37,006
Loans and leases, incl. loans-held-for-sale (2)	3,898,250	4.09	159,456	3,622,033	3.98	144,224	3,385,741	3.90	132,028
Federal Home Loan Bank stock	8,990	2.40	215	7,033	1.79	126	10,534	1.70	179
Total interest-earning assets	5,395,477	3.69	199,276	5,182,832	3.56	184,648	4,890,426	3.46	169,280
Noninterest-earning assets	292,599			328,174			359,687		
Total assets	$ 5,688,076			$ 5,511,006			$ 5,250,113		
Liabilities and Equity									
Interest-bearing liabilities:									
Interest-bearing demand deposits	$ 936,034	0.08%	$ 734	$ 901,171	0.07%	$ 641	$ 844,507	0.06%	$ 489
Savings and money market deposits	1,494,658	0.13	2,000	1,449,379	0.08	1,099	1,406,754	0.07	1,043
Time deposits under $100,000	177,936	0.51	910	188,951	0.40	758	204,940	0.38	770
Time deposits $100,000 and over	1,016,643	1.56	15,860	984,069	0.88	8,699	879,989	0.38	3,304
Total interest-bearing deposits	3,625,271	0.54	19,504	3,523,570	0.32	11,197	3,336,190	0.17	5,606
Federal Home Loan Bank advances and other short-term borrowings	50,630	2.44	1,236	15,531	1.18	183	110,928	0.52	578
Long-term debt	97,746	4.66	4,556	92,785	3.75	3,479	92,785	3.24	3,005
Total interest-bearing liabilities	3,773,647	0.67	25,296	3,631,886	0.41	14,859	3,539,903	0.26	9,189
Noninterest-bearing deposits	1,385,427			1,325,583			1,156,906		
Other liabilities	42,157			40,097			40,029		
Total liabilities	5,201,231			4,997,566			4,736,838		
Shareholders' equity	486,841			513,416			513,255		
Non-controlling interest	4			24			20		
Total equity	486,845			513,440			513,275		
Total liabilities and equity	$ 5,688,076			$ 5,511,006			$ 5,250,113		
Net interest income			$ 173,980			$ 169,789			$ 160,091
Interest rate spread		3.02%			3.15%			3.20%	
Net interest margin		3.22%			3.28%			3.27%	

(1) At amortized cost.

(2) Includes nonaccrual loans.

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

	2018 Compared to 2017			2017 Compared to 2016		
	Increase (Decrease) Due to Change In:			Increase (Decrease) Due to Change In:		
	Volume	Rate	Net Change	Volume	Rate	Net Change
	(Dollars in thousands)					
Interest-earning assets						
Interest-bearing deposits in other financial institutions	$ (156)	$ 165	$ 9	$ 101	$ 188	$ 289
Investment securities, excluding valuation allowance:						
Taxable	(1,054)	1,634	580	1,039	2,053	3,092
Tax-exempt	(201)	(1,081)	(1,282)	(138)	(18)	(156)
Total investment securities	(1,255)	553	(702)	901	2,035	2,936
Loans and leases, incl. loans-held-for-sale	10,958	4,274	15,232	9,278	2,918	12,196
Federal Home Loan Bank stock	35	54	89	(59)	6	(53)
Total interest-earning assets	9,582	5,046	14,628	10,221	5,147	15,368
Interest-bearing liabilities						
Interest-bearing demand deposits	19	74	93	42	110	152
Savings and money market deposits	41	860	901	10	46	56
Time deposits under $100,000	(44)	196	152	(32)	20	(12)
Time deposits $100,000 and over	285	6,876	7,161	402	4,993	5,395
Total interest-bearing deposits	301	8,006	8,307	422	5,169	5,591
Federal Home Loan Bank advances and other short-term borrowings	414	639	1,053	(499)	104	(395)
Long-term debt	186	891	1,077	—	474	474
Total interest-bearing liabilities	901	9,536	10,437	(77)	5,747	5,670
Net interest income	$ 8,681	$ (4,490)	$ 4,191	$ 10,298	$ (600)	$ 9,698

Net interest income is our primary source of earnings and is derived primarily from the difference between the interest we earn on loans and investments versus the interest we pay on deposits and borrowings. Net interest income (expressed on a taxable-equivalent basis) totaled $174.0 million in 2018, which increased by $4.2 million, or 2.5%, from $169.8 million in 2017, which increased by $9.7 million, or 6.1%, from net interest income of $160.1 million recognized in 2016. The increase in net interest income for 2018 was primarily the result of a significant increase in average loans and leases as we continued to redeploy our excess liquidity into higher yielding assets, combined with increases in average yields earned on the loans and leases and taxable investment securities portfolios. Partially offsetting the increase was the 68 basis points ("bp") increase in interest rates paid on time deposits $100,000 and over, primarily attributable to the increase in rates paid on government time deposits. Time deposits $100,000 and over primarily consists of public funds which may be opportunistic sources of funding, but fluctuate more directly with changes in Federal Funds rates. The increase was also partially offset by a lower tax-equivalent adjustment on the tax-exempt investment securities portfolio due to Tax Reform.

Average yields earned on our interest-earning assets increased by 13 bp in the year ended December 31, 2018, from the year ended December 31, 2017. Average rates paid on our interest-bearing liabilities in the year ended December 31, 2018 increased by 26 bp from the year ended December 31, 2017. The increase in average rates paid on our interest-bearing liabilities in 2018 was primarily attributable to the 68 bp increase in average rates paid on our time deposits $100,000 and over.

In the second quarter of 2017, we completed an investment portfolio repositioning strategy designed to enhance potential prospective earnings and improve net interest margin. In connection with the repositioning, we sold $97.7 million in lower-yielding available-for-sale securities, and purchased $97.4 million in higher-yielding, longer duration investment securities. The investment securities sold had an average yield of 1.91% and a weighted average life of 3.3 years. Gross proceeds of the sale of $96.0 million were immediately reinvested back into investment securities with an average yield of 2.57% and a weighted

average life of 4.6 years. The new securities were classified in the available-for-sale portfolio. There were no gross realized gains on the sale of the investment securities. Gross realized losses on the sale of the investment securities were $1.6 million. The specific identification method was used as the basis for determining the cost of all securities sold.

Interest Income

Our primary sources of interest income include interest on loans and leases, which represented 80.0%, 78.1%, and 78.0% of taxable-equivalent interest income in 2018, 2017 and 2016, respectively, as well as interest earned on investment securities, which represented 19.7%, 21.6%, and 21.9% of taxable-equivalent interest income, respectively. Interest income expressed on a taxable-equivalent basis of $199.3 million in 2018 increased by $14.6 million, or 7.9%, from the $184.6 million earned in 2017, which increased by $15.4 million, or 9.1%, from the $169.3 million earned in 2016.

As depicted in Table 2, the increase in interest income in 2018 from 2017 was primarily due to a significant increase in average loans and leases and taxable investment securities balances, combined with higher yields earned on the loans and leases and taxable investment securities portfolios. The $276.2 million increase in average loans and leases contributed to an increase of $11.0 million in current year interest income. The 11 bp and 14 bp increases in average yields earned on the loans and leases and taxable investment securities portfolios contributed to increases of $4.3 million and $1.6 million in current year interest income, respectively. These positive variances were partially offset by the $46.9 million decrease in average taxable investment securities which contributed to a decrease $1.1 million in current year interest income, combined with a $1.0 million lower taxable-equivalent adjustment on tax-exempt investment securities due to the reduction in the corporate federal income tax rate from 35% to 21% due to Tax Reform.

The increase in interest income in 2017 from 2016 was primarily due to a significant increase in average loans and leases and taxable investment securities balances, combined with higher yields earned on the loans and leases and taxable investment securities portfolios. The $236.3 million increase in average loans and leases contributed to an increase of $9.3 million in current year interest income. The $43.5 million increase in average taxable investment securities contributed to an increase of $1.0 million in current year interest income. The 8 bp and 15 bp increases in average yields earned on the loans and leases and taxable investment securities portfolios contributed to increases of $2.9 million and $2.1 million in current year interest income, respectively.

Interest Expense

In 2018, interest expense was $25.3 million which represented an increase of $10.4 million, or 70.2%, compared to interest expense of $14.9 million in 2017, which was an increase of $5.7 million, or 61.7%, compared to $9.2 million in 2016.

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

In 2017, the increase in the average rates paid on time deposits $100,000 and over of 50 bp, long-term debt of 51 bp, and Federal Home Loan Bank advances and other short-term borrowings of 66 bp contributed to the increase in interest expense in 2017 from 2016 of $5.0 million, $0.5 million, and $0.1 million, respectively.

Net Interest Margin

Our net interest margin was 3.22%, 3.28% and 3.27% in 2018, 2017 and 2016, respectively. As part of Tax Reform, the U.S. corporate federal income tax rate decreased from 35% to 21% for the year beginning January 1, 2018. The lower tax rate resulted in the reduction of the taxable-equivalent yield on tax-exempt investment securities, which reduced net interest margin by approximately 2 bp in 2018. The decline in our net interest margin in 2018 from 2017 also reflected the 68 bp, 91 bp, and 126 bp increases in average rates paid on time deposits $100,000 and over, long-term debt, and Federal Home Loan Bank advances and other short-term borrowings, respectively.

The increase in our net interest margin in 2017 from 2016 reflected the 8 bp and 15 bp increases in average yields earned on the loans and leases and taxable investment securities portfolios, respectively, partially offset by a 50 bp increase in average rates paid on time deposits $100,000 and over.

The historically low interest rate environment that we continue to operate in is the result of the target Federal Funds range of 0%-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 2015 and 2016, the Federal Reserve increased the target Federal

Funds range by 25 bp each year 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 three times in 2017, each by 25 bp to 1.25%-1.50% as of December 31, 2017. Furthermore, the Federal Reserve announced their intent to remove monetary policy accommodation through the gradual unwind of their balance sheet that grew following the recession through their quantitative easing programs.

In December 2018, the Federal Reserve raised the target Federal Funds range by 25 bp for the fourth time in 2018, to 2.25%-2.50%.

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

Other Operating Income

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

Table 3. Components of Other Operating Income

	Year Ended December 31,			Dollar Change		Percent Change	
(Dollars in thousands)	**2018**	**2017**	**2016**	**2018 to 2017**	**2017 to 2016**	**2018 to 2017**	**2017 to 2016**
Mortgage banking income:							
Loan servicing fees	$ 5,159	$ 5,337	$ 5,421	$ (178)	$ (84)	(3.3)%	(1.5)%
Amortization of mortgage servicing rights	(1,859)	(2,288)	(5,066)	429	2,778	(18.8)	(54.8)
Net gain on sale of residential mortgage loans	4,085	4,069	7,631	16	(3,562)	0.4	(46.7)
Unrealized gain (loss) on interest rate locks	(70)	(156)	83	86	(239)	(55.1)	(288.0)
Service charges on deposit accounts	8,406	8,468	7,891	(62)	577	(0.7)	7.3
Other service charges and fees	13,123	11,518	11,449	1,605	69	13.9	0.6
Income from fiduciary activities	4,245	3,674	3,435	571	239	15.5	7.0
Income from bank-owned life insurance	2,117	3,388	2,685	(1,271)	703	(37.5)	26.2
Net gain on sales of foreclosed assets	—	205	607	(205)	(402)	(100.0)	(66.2)
Gain on sale of premises and equipment	—	—	3,537	—	(3,537)	N.M.	(100.0)
Equity in earnings of unconsolidated subsidiaries	233	602	723	(369)	(121)	(61.3)	(16.7)
Fees on foreign exchange	905	529	519	376	10	71.1	1.9
Loan placement fees	747	536	494	211	42	39.4	8.5
Net losses on sales of investment securities	(279)	(1,410)	—	1,131	(1,410)	(80.2)	N.M.
Other:							
Income recovered on nonaccrual loans previously charged-off	720	767	1,325	(47)	(558)	(6.1)	(42.1)
Other recoveries	221	149	313	72	(164)	48.3	(52.4)
Commissions on sale of checks	328	341	340	(13)	1	(3.8)	0.3
Other	723	767	929	(44)	(162)	(5.7)	(17.4)
Total other operating income	$ 38,804	$ 36,496	$ 42,316	$ 2,308	$ (5,820)	6.3	(13.8)
Total other operating income as a percentage of average assets	0.68%	0.66%	0.81%				

Total other operating income of $38.8 million in 2018 increased by $2.3 million, or 6.3%, from the $36.5 million earned in 2017, which decreased by $5.8 million, or 13.8%, from the $42.3 million earned in 2016.

The increase in other operating income in 2018 from 2017 was primarily due to net losses on sales of investment securities of $1.4 million recognized in 2017, primarily attributable to the investment portfolio repositioning completed in 2017, compared to net losses on sales of investment securities of $0.3 million recognized in 2018. In addition, in 2018 we recognized higher commissions and fees on investment services of $1.2 million (included in other service charges and fees), higher income from fiduciary activities of $0.6 million, higher mortgage banking income of $0.4 million and higher fees on foreign exchange of $0.4 million. The higher mortgage banking income was primarily due to lower amortization of mortgage servicing rights of $0.4 million. These increases were partially offset by lower income from bank-owned life insurance of $1.3 million and lower equity in earnings of unconsolidated subsidiaries of $0.4 million. The lower income from bank-owned life insurance was primarily attributable to death benefit income of $1.1 million recognized in 2017 compared to $0.5 million recognized in 2018, combined with volatility in the equity markets in 2018.

The decrease in other operating income in 2017 from 2016 was primarily due to a $3.5 million gain on the sale of the Company's fee interest in a former branch location recognized in 2016, combined with net losses on sales of investment securities of $1.4 million recognized in 2017. The investment securities losses were primarily attributable to the investment portfolio repositioning completed in 2017. In addition, in 2017 we recorded lower mortgage banking income of $1.1 million and lower income recovered on loans previously charged-off of $0.6 million compared to 2016. The lower mortgage banking income was primarily due to a lower net gain on sale of residential mortgage loans of $3.6 million, partially offset by lower amortization of mortgage servicing rights of $2.8 million compared to 2016. These decreases were partially offset by higher income from bank-owned life insurance of $0.7 million, primarily attributable to death benefit income, and higher service charges on deposit accounts of $0.6 million compared to 2016.

Other Operating Expense

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

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

Table 4. Components of Other Operating Expense

	Year Ended December 31,			Dollar Change		Percent Change	
(Dollars in thousands)	**2018**	**2017**	**2016**	**2018 to 2017**	**2017 to 2016**	**2018 to 2017**	**2017 to 2016**
Salaries and employee benefits	$ 75,352	$ 72,286	$ 73,500	$ 3,066	$ (1,214)	4.2 %	(1.7)%
Net occupancy	13,763	13,571	14,065	192	(494)	1.4	(3.5)
Legal and professional services	7,330	7,724	6,856	(394)	868	(5.1)	12.7
Computer software expense	9,841	9,192	9,475	649	(283)	7.1	(3.0)
Amortization of core deposit premium	2,006	2,674	2,675	(668)	(1)	(25.0)	—
Communication expense	3,410	3,659	3,694	(249)	(35)	(6.8)	(0.9)
Equipment	4,239	3,785	3,399	454	386	12.0	11.4
Advertising expense	2,675	2,408	2,401	267	7	11.1	0.3
Foreclosed asset expense	574	151	152	423	(1)	280.1	(0.7)
Other:							
Charitable contributions	635	593	660	42	(67)	7.1	(10.2)
FDIC insurance assessment	1,732	1,724	2,052	8	(328)	0.5	(16.0)
Miscellaneous loan expenses	1,365	1,144	1,189	221	(45)	19.3	(3.8)
ATM and debit card expenses	2,645	1,961	1,771	684	190	34.9	10.7
Armored car expenses	822	873	879	(51)	(6)	(5.8)	(0.7)
Entertainment and promotions	1,062	1,660	1,101	(598)	559	(36.0)	50.8
Stationery and supplies	914	814	902	100	(88)	12.3	(9.8)
Directors' fees and expenses	1,040	873	827	167	46	19.1	5.6
Provision (credit) for residential mortgage loan repurchase losses	150	209	(387)	(59)	596	(28.2)	(154.0)
Reserve (credit) for unfunded loan commitments	(425)	94	141	(519)	(47)	(552.1)	(33.3)
Branch consolidation and relocation costs	—	—	737	—	(737)	N.M.	(100.0)
Other	5,552	5,678	6,429	(126)	(751)	(2.2)	(11.7)
Total other operating expense	$ 134,682	$ 131,073	$ 132,518	$ 3,609	$ (1,445)	2.8	(1.1)
Total other operating expense as a percentage of average assets	2.37%	2.38%	2.52%				

Total other operating expense of $134.7 million in 2018 increased by $3.6 million, or 2.8%, from total operating expense of $131.1 million in 2017, which decreased by $1.4 million, or 1.1%, compared to 2016.

The increase in total other operating expense in 2018, compared to 2017, was primarily due to the increase in salaries and employee benefits of $3.1 million, higher ATM and debit card expenses of $0.7 million, higher computer software expense of $0.6 million and higher equipment expense of $0.5 million. The increase in salaries and employee benefits was primarily attributable to increases in the Company's starting pay rate effective January 1, 2018, combined with merit salary increases effective in the second quarter of 2018. During the fourth quarter of 2018, the Company increased its starting pay rate for the second time in a year, effective December 1, 2018. These increases were partially offset by lower amortization of core deposit premium of $0.7 million, lower entertainment and promotions expense of $0.6 million and a credit to the reserve for unfunded commitments of $0.4 million (included in other) in 2018, compared to an increase to the reserve for unfunded commitments of $0.1 million (included in other) in 2017.

The decrease in total other operating expense in 2017, compared to 2016, was primarily due to lower salaries and employee benefits of $1.2 million, lower branch consolidation and relocation costs of $0.7 million, lower net occupancy expense of $0.5 million, and lower FDIC insurance assessment, and computer software expenses of $0.3 million each. The lower salaries and

employee benefits are primarily due to lower pension expense in 2017 of $4.1 million, partially offset by merit increases and $0.8 million in special, one-time bonuses given to all employees, with the exception of executives on its managing committee, in the fourth quarter of 2017. In the fourth quarter of 2016, the Company executed a defined benefit pension plan de-risking strategy whereby the Company purchased non-participating annuity contracts to settle the pension obligation for a portion of its plan participants. This resulted in the immediate recognition of $3.8 million in net actuarial losses. In the fourth quarter of 2016, the Company also recognized a $0.7 million charge related to the early termination of a lease (included in branch consolidation and relocation costs). These decreases were partially offset by increases in legal and professional services of $0.9 million, provision for residential mortgage repurchase loan losses of $0.6 million, entertainment and promotions of $0.6 million, and equipment expenses of $0.4 million.

A key measure of operating efficiency tracked by management is the efficiency ratio, which is calculated by dividing total other operating expenses by total revenue (net interest income plus other operating income). Management believes that the efficiency ratio provides useful supplemental information that is important to a proper understanding of the company's core business results by investors. Our efficiency ratio should not be viewed as a substitute for results determined in accordance with GAAP, nor is it necessarily comparable to the efficiency ratio presented by other companies. Our efficiency ratio decreased to 63.59% in 2018, compared to 64.19% in 2017 and 66.17% in 2016. The decrease in our efficiency ratio in 2018 was primarily driven by the aforementioned increases in net interest income and other operating income, partially offset by an increase in other operating expenses.

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

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

Table 5. Reconciliation of Efficiency Ratio

	Year Ended December 31, 2018				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
As Reclassified:					
Total other operating expenses	$ 134,682	$ 131,073	$ 132,518	$ 125,964	$ 128,793
Net interest income	172,998	167,703	157,950	$ 149,528	$ 143,418
Total other operating income	38,804	36,496	42,316	34,799	41,166
Total revenue	$ 211,802	$ 204,199	$ 200,266	$ 184,327	$ 184,584
Efficiency ratio	63.59 %	64.19 %	66.17 %	68.34 %	69.77 %
Unadjusted:					
Total other operating expenses	$ 135,687	$ 131,817	$ 133,563	$ 127,042	$ 130,156
Net interest income	$ 172,998	$ 167,703	$ 157,950	$ 149,528	$ 143,418
Total other operating income	38,804	36,496	42,316	34,799	41,166
Total revenue	$ 211,802	$ 204,199	$ 200,266	$ 184,327	$ 184,584
Efficiency ratio	64.06 %	64.55 %	66.69 %	68.92 %	70.51 %
Impact of Change:					
Total operating expenses	$ (1,005)	$ (744)	$ (1,045)	$ (1,078)	$ (1,363)
Net interest income	—	—	—	$ —	$ —
Total other operating income	—	—	—	—	—
Total revenue	$ —	$ —	$ —	$ —	$ —
Efficiency ratio	(0.47)%	(0.36)%	(0.52)%	(0.58)%	(0.74)%

Income Taxes

In 2018, the Company recorded income tax expense of $18.8 million, compared to $34.6 million in 2017, and $26.3 million in 2016. Our effective tax rate was 24.0% in 2018 compared to 45.6% in 2017 and 35.9% in 2016. The decreases in income tax expense and the effective tax rate in 2018 from 2017 were primarily due to the reduction in the corporate federal income tax rate due to Tax Reform. In addition and as previously discussed, based on the Company's evaluation of the impact of Tax Reform on its DTA, the Company recorded a one-time, non-cash estimated charge of $7.4 million of additional income tax expense in December 2017 to reflect the reduction of the future tax benefits and liabilities in the balance sheet based on this reduced rate. In 2018, the Company recorded an income tax benefit of $1.5 million related to the finalization of the impact of Tax Reform, which also included the impact of a tax method change for software development and prepaid expenses that was filed in 2018.

As of December 31, 2018, the valuation allowance on our net DTA totaled $3.5 million, of which $3.3 million related to our DTA from net apportioned net operating loss ("NOL") carryforwards for California state income tax purposes as we do not expect to generate sufficient income in California to utilize the DTA. The remaining $0.2 million relates to a valuation allowance on the Hawaii capital loss carryforward balance that we do not expect to be able to utilize. Net of this valuation

allowance, the Company's net DTA totaled $21.5 million as of December 31, 2018, compared to a net DTA of $26.5 million as of December 31, 2017, and is included in other assets on our consolidated balance sheets.

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

Financial Condition

Total assets of $5.81 billion at December 31, 2018 increased by $183.3 million, or 3.3%, from the $5.62 billion at December 31, 2017, and total liabilities of $5.32 billion at December 31, 2018 increased by $191.6 million, or 3.7%, from the $5.12 billion at December 31, 2017. The increase in total assets and total liabilities in 2018 was primarily due to our strong loan growth, funded by the proceeds from maturities of our available-for-sale investment securities portfolio, increase in core deposits, and additional short-term borrowings and long-term debt.

Loan Portfolio

Our lending activities are focused on commercial, financial and agricultural loans, commercial mortgages, and construction loans to small and medium-sized companies, business professionals, and real estate investors and developers, as well as residential mortgages, home equity and consumer loans to local home-buyers and individuals. Our strategy for generating commercial loans has traditionally relied upon teams of commercial real estate and commercial banking officers organized by geographical and industry lines who are responsible for client prospecting and business development.

To manage credit risk (i.e., the ability of borrowers to repay their loan obligations), management analyzes the borrower's financial condition, repayment source, collateral and other factors that could impact credit quality, such as national and local economic conditions and industry conditions related to respective borrowers. The general underwriting guidelines require analysis and documentation to include among other things, overall credit worthiness of borrower, guarantor support, use of funds, loan term, minimum equity, loan-to-value standards, repayment terms, sources of repayment, covenants, pricing, collateral, insurance, and documentation standards. All loan requests considered by us should be for a clearly defined legitimate purpose with a determinable primary source, as well as alternate sources of repayment. All loans should be supported by appropriate documentation including, current financial statements, credit reports, collateral information, asset verification, tax returns, title reports, and appraisals (where appropriate).

We score consumer and small business loans using underwriting matrices ("Scorecards") developed based on the results of an analysis from a reputable national credit scoring company commissioned by our Bank. The Scorecards use the attributes that were determined to most highly correlate with probability of repayment. Those attributes include (i) credit score, (ii) credit limit amount, and (iii) debt-to-income ratio.

Loans and leases totaled $4.08 billion at December 31, 2018, which increased by $307.8 million, or 8.2%, from the $3.77 billion at December 31, 2017, which increased by $245.7 million, or 7.0%, from the $3.52 billion held at December 31, 2016. The increase in our loan portfolio in 2018 was representative of our continued effort to deploy excess liquidity into higher yielding assets. The increase in loans and leases was primarily due to net increases in the following loan portfolios: residential mortgage of $87.0 million, or 6.5%, commercial, financial, and agricultural of $77.6 million, or 15.4%, commercial mortgage of $62.5 million, or 6.4%, home equity of $56.7 million, or 13.8%, consumer of $21.5 million, or 4.6% and construction of $2.7 million, or 4.2%. In 2018, we foreclosed on one portfolio loan with a carrying value of $40 thousand, which was sold at a small premium to book value. In addition, we recorded charge-offs of loans and leases of $10.2 million.

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

Table 6. Loans by Categories

	December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Commercial, financial and agricultural	$ 581,660	$ 504,019	$ 510,440	$ 521,086	$ 463,763
Real estate:					
Construction	66,927	64,240	101,538	84,885	114,554
Residential mortgage	1,428,205	1,341,221	1,217,234	1,134,325	1,054,005
Home equity	468,966	412,230	361,209	301,980	228,319
Commercial mortgage	1,040,278	977,797	885,439	760,749	703,273
Consumer	492,206	470,746	448,353	407,479	365,144
Leases	124	362	677	1,028	3,140
Total loans and leases	4,078,366	3,770,615	3,524,890	3,211,532	2,932,198
Allowance for loan and lease losses	(47,916)	(50,001)	(56,631)	(63,314)	(74,040)
Net loans and leases	$ 4,030,450	$ 3,720,614	$ 3,468,259	$ 3,148,218	$ 2,858,158

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

Table 7. Geographic Distribution

	December 31, 2018			December 31, 2017		
	Hawaii	U.S. Mainland	Total	Hawaii	U.S. Mainland	Total
	(Dollars in thousands)					
Commercial, financial and agricultural	$ 439,112	$ 142,548	$ 581,660	$ 400,529	$ 103,490	$ 504,019
Real estate:						
Construction	64,654	2,273	66,927	61,643	2,597	64,240
Residential mortgage	1,428,205	—	1,428,205	1,341,221	—	1,341,221
Home equity	468,966	—	468,966	412,230	—	412,230
Commercial mortgage	861,086	179,192	1,040,278	807,009	170,788	977,797
Consumer	357,908	134,298	492,206	322,713	148,033	470,746
Leases	124	—	124	362	—	362
Total loans and leases	3,620,055	458,311	4,078,366	3,345,707	424,908	3,770,615
Allowance for loan and lease losses	(42,993)	(4,923)	(47,916)	(44,779)	(5,222)	(50,001)
Net loans and leases	$ 3,577,062	$ 453,388	$ 4,030,450	$ 3,300,928	$ 419,686	$ 3,720,614

Commercial, Financial and Agricultural

Loans in this category consist primarily of term loans and lines of credit to small and middle-market businesses and professionals. The borrower's business is typically regarded as the principal source of repayment, although our underwriting policy and practice generally requires additional sources of collateral, including real estate and other business assets, as well as personal guarantees where possible to mitigate risk. Risk of credit losses could be greater in this loan category relative to secured loans where a greater percentage of the loan amount is usually covered by collateral. Nonetheless, any collateral or personal guarantees obtained on commercial loans can mitigate the increased risk and help to reduce credit losses.

Our historical approach to commercial lending involves teams of lending and cash management personnel who focus on relationship development including loans, deposits and other bank services to new and existing commercial clients.

Our commercial, financial, and agricultural loan portfolio increased by $77.6 million in 2018, after decreasing by $6.4 million and $10.6 million in 2017 and 2016, respectively. Our commercial, financial, and agricultural loan portfolio increased by $57.3 million in 2015. The increase in 2018 was primarily attributable to growth in the U.S. Mainland shared national credit balances of $39.1 million, combined with growth in the Hawaii portfolio of $38.6 million.

Real Estate—Construction

Construction loans include both residential and commercial development projects. Each construction project is evaluated for economic viability. Construction loans pose higher credit risks than typical secured loans. In addition to the financial strength of the borrower, construction loans have the added element of completion risk, which is the risk that the project will not be completed on time and within budget, resulting in additional costs that could affect the economic viability of the project and market risk at the time construction is complete.

In 2018, our construction loan portfolio increased by $2.7 million. Our construction loan portfolio decreased by $37.3 million in 2017, increased by $16.7 million in 2016, and decreased by $29.7 million in 2015. These fluctuations are driven by the start and completion of construction projects and are consistent with a normal construction cycle.

Interest Reserves

Our policies require interest reserves for construction loans, including loans to build commercial buildings, residential developments (both large tract projects and individual houses), and multi-family projects.

The outstanding principal balance of loans with interest reserves was $25.2 million at December 31, 2018, compared to $27.1 million in the prior year, while remaining interest reserves was $4.0 million, or 15.7% of the outstanding principal balance of loans with interest reserves at December 31, 2018, compared to $1.3 million, or 5.0% of the outstanding principal balance of loans with interest reserves at December 31, 2017.

Interest reserves allow the Company to advance funds to borrowers to make scheduled payments during the construction period. These advances typically are capitalized and added to the borrower's outstanding loan balance, although we have the right to demand payment under certain circumstances. Our policy is to determine if interest reserve amounts are appropriately included in each project's construction budget and are adequate to cover the expected duration of the construction period.

The amount, terms, and conditions of the interest reserve are established when a loan is originated, although we generally have the option to demand payment if the credit profile of the borrower changes. We evaluate the viability and appropriateness of the construction project based on the project's complexity and feasibility, the timeline, as well as the creditworthiness of the borrowers, sponsors and/or guarantors, and the value of the collateral.

In the event that unfavorable circumstances alter the original project schedule (e.g., cost overruns, project delays, etc.), our policy is to evaluate whether or not it is appropriate to maintain interest capitalization or demand payment of interest in cash and we will work with the borrower to explore various restructuring options, which may include obtaining additional equity and/or requiring additional collateral. We may also require borrowers to directly pay scheduled interest payments.

Our process for determining that construction projects are moving as planned are detailed in our lending policies and guidelines. Prior to approving a loan, the Company and borrower generally agree on a construction budget, a proforma monthly disbursement schedule, and sales/leaseback assumptions. As each project progresses, the projections are measured against actual disbursements and sales/lease results to determine if the project is on schedule and performing as planned.

The specific monitoring requirements for each loan vary depending on the size and complexity of the project and the experience and financial strength of the borrower, sponsor and/or guarantor. At a minimum, to ensure that loan proceeds are properly disbursed and to assess whether it is appropriate to capitalize interest or demand cash payment of interest, our monitoring process generally includes:

- Physical inspection of the project to ensure work has progressed to the stage for which payment is being requested;
- Verification that the work completed is in conformance with plans and specifications and items for which disbursement is requested are within budget; and
- Determination that there continues to be satisfactory project progress.

In certain rare circumstances, we may decide to extend, renew, and/or restructure the terms of a construction loan. Reasons for the restructure can range from cost overruns to project delays and the restructuring can result in additional funds being advanced or an extension of the maturity date of the loan. Prior to the loan being restructured, our policy is to perform a

detailed analysis to ensure that the economics of the project remain feasible and that the risks to the Company are within acceptable lending guidelines.

Real Estate—Mortgage

The following table sets forth information with respect to the composition of the Real Estate—Mortgage loan portfolio as of the dates indicated.

Table 8. Mortgage Loan Portfolio Composition

	December 31,									
	2018		2017		2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Residential:										
Closed-end loans	$1,428,205	48.6%	$1,341,221	49.1%	$1,217,234	49.4%	$1,134,325	51.7%	$1,054,005	53.1%
Home equity line-of-credit ("HELOC")	468,966	16.0	412,230	15.1	361,209	14.7	301,980	13.7	228,319	11.5
Subtotal	1,897,171	64.6	1,753,451	64.2	1,578,443	64.1	1,436,305	65.4	1,282,324	64.6
Commercial mortgage	1,040,278	35.4	977,797	35.8	885,439	35.9	760,749	34.6	703,273	35.4
Total mortgage loans	$2,937,449	100.0%	$2,731,248	100.0%	$2,463,882	100.0%	$2,197,054	100.0%	$1,985,597	100.0%

Residential

Residential mortgage loans include fixed-rate and adjustable-rate loans primarily secured by single-family owner-occupied primary residences in Hawaii. Maximum loan-to-value ratios of 80% are typically required for fixed-rate and adjustable-rate loans secured by single-family owner-occupied residences, although higher levels are permitted with accompanying mortgage insurance. First mortgage loans secured by residential properties generally carry a moderate level of credit risk. With an average loan size of approximately $0.5 million, marketable collateral and a stable Hawaii residential real estate market, credit losses on residential mortgage loans have been minimal during the past several years. However, economic conditions including unemployment levels, future changes in interest rates and other market factors can impact the marketability and value of collateral and thus the level of credit risk inherent in the portfolio.

Closed-end residential mortgage loan balances as of December 31, 2018 totaled $1.43 billion, increasing by $87.0 million, or 6.5%, from the $1.34 billion held at year-end 2017, which increased by $124.0 million, or 10.2%, from the $1.22 billion held at year-end 2016. The increase in closed-end residential mortgage loan balances in 2018 was primarily due to the reinvestment of cash flow into higher yielding assets and increased demand from both new and existing customers.

Residential mortgage loans held for sale at December 31, 2018 totaled $6.6 million, a decrease of $9.7 million, or 59.3%, from the December 31, 2017 balance of $16.3 million, which decreased by $15.5 million, or 48.8%, from the December 31, 2016 balance of $31.9 million. We did not securitize any residential mortgage loans in 2018, 2017 and 2016.

Home Equity

Home equity lines of credit ("HELOCs"), which typically carry floating interest rates, are underwritten according to policy and guidelines reviewed and approved by the Board of Directors. All HELOCs originated since early 2011 have a ten year draw period followed by a 20 year repayment period during which the principal balance will be fully amortized. HELOCs are underwritten using a qualifying payment which assumes the line is fully drawn and is amortizing as if it was in the repayment period. Underwriting criteria include a minimum FICO score, maximum debt-to-income ratio (DTI), and maximum combined loan-to-value ratio (CLTV). HELOCs are monitored based on default, delinquency, end of draw period, and maturity.

HELOC balances as of December 31, 2018 totaled $469.0 million, increasing by $56.7 million, or 13.8%, from the $412.2 million held at year-end 2017, which increased by $51.0 million, or 14.1%, from the $361.2 million held at year-end 2016.

Commercial

Real estate mortgage loans secured by commercial properties continue to represent a sizable portion of our loan portfolio. Our policy with respect to commercial mortgages is that loans be made for sound purposes, have a definite source and/or plan of repayment established at inception, and be backed up by reliable secondary sources of repayment and satisfactory collateral with good marketability. Loans secured by commercial property carry a greater risk than loans secured by residential property due to operating income risk. Operating income risk is the risk that the borrower will be unable to generate sufficient cash flow from the operation of the property. The commercial real estate market and interest rate conditions through economic cycles will impact risk levels.

Commercial mortgage balances as of December 31, 2018 totaled $1.04 billion, increasing by $62.5 million, or 6.4%, from the $977.8 million held at year-end 2017, which increased by $92.4 million, or 10.4%, from the $885.4 million held at year-end 2016. The increase in commercial mortgage balances in 2018 was primarily due to increased demand from both new and existing customers.

Consumer Loans

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

Table 9. Consumer Loan Portfolio Composition

	December 31,									
	2018		2017		2016		2015		2014	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
	(Dollars in thousands)									
Automobile	$284,170	57.7%	$275,793	58.6%	$212,926	47.5%	$190,202	46.7%	$150,559	41.2%
Other revolving credit plans	83,158	16.9	77,305	16.4	81,124	18.1	73,756	18.1	67,099	18.4
Student loans	8,644	1.8	14,920	3.2	25,053	5.6	38,636	9.5	57,776	15.8
Other	116,234	23.6	102,728	21.8	129,250	28.8	104,885	25.7	89,710	24.6
Total consumer	$492,206	100.0%	$470,746	100.0%	$448,353	100.0%	$407,479	100.0%	$365,144	100.0%

For consumer loans, credit risk is managed on a pooled basis. Considerations include an evaluation of the quality, character and inherent risks in the loan portfolio, current and projected economic conditions and past loan loss experience. Consumer loans represent a moderate credit risk. Loans in this category are generally either unsecured or secured by personal assets such as automobiles. The average loan size is generally small and risk is diversified among many borrowers. Our policy is to utilize credit-scoring systems for most of our consumer loans, which offer the ability to modify credit exposure based on our risk tolerance and loss experience. From time to time, we will tactically deploy funds, which are not utilized in our current short-term core lending markets, by purchasing certain consumer loan portfolios.

Consumer loans totaled $492.2 million at December 31, 2018, increasing by $21.5 million, or 4.6%, from year-end 2017 of $470.7 million, which increased by $22.4 million, or 5.0%, compared to the $448.4 million held at year-end 2016. At December 31, 2018, automobile loans, primarily indirect dealer loans, comprised 57.7% of consumer loans outstanding.

Total automobile loans of $284.2 million at December 31, 2018 increased by $8.4 million, or 3.0%, from year-end 2017 of $275.8 million, which increased by $62.9 million, or 29.5%, from $212.9 million at year-end 2016.

In 2018, we purchased an auto loan portfolio totaling $20.6 million, which included a $0.1 million premium over the $20.5 million outstanding balance. In 2017, we purchased three auto loan portfolios totaling $83.8 million, which included $2.3 million in premiums over the $81.4 million outstanding balance. In 2016, we purchased two auto loan portfolios totaling $41.2 million, which included $0.9 million in premiums over the $40.3 million outstanding balance. In 2015, we purchased two auto loan portfolios totaling $52.8 million, which included $1.7 million in premiums over the $51.1 million outstanding balance. In 2014, we purchased a participation interest in auto loans totaling $11.2 million, which included a $0.3 million premium over the $10.9 million outstanding balance.

Other revolving credit plans loans include extensions of credit to individuals and totaled $83.2 million at December 31, 2018, which increased by $5.9 million, or 7.6%, from year-end 2017 of $77.3 million, which decreased by $3.8 million, or 4.7%, from $81.1 million at year-end 2016.

Total student loans of $8.6 million at December 31, 2018 decreased by $6.3 million, or 42.1%, from year-end 2017 of $14.9 million, which decreased by $10.1 million, or 40.4%, from $25.1 million at year-end 2016, primarily due to run-off.

In 2014, we purchased participation interests in student loans totaling $51.5 million, which represented the outstanding balance at the time of purchase.

Other consumer loans of $116.2 million at December 31, 2018 increased by $13.5 million, or 13.1%, from year-end 2017 of $102.7 million, which decreased by $26.5 million, or 20.5%, from $129.3 million at year-end 2016.

In 2018, 2016 and 2015, we also purchased fixed-rate unsecured consumer loan portfolios (included in other) totaling $38.0 million, $35.7 million and $15.9 million, respectively, which represented the outstanding balances at the time of purchase.

Concentrations of Credit Risk

As of December 31, 2018, approximately $3.00 billion, or 73.7% of loans outstanding were real estate-related, including construction loans, residential mortgage loans, home equity loans, and commercial mortgage loans.

The majority of our loans are made to companies and individuals with headquarters in, or residing in, the state of Hawaii. Consistent with our focus of being a Hawaii-based bank, 88.8% of our loan portfolio was concentrated in the Hawaii market while 11.2% was concentrated in the U.S. Mainland as of December 31, 2018.

Our foreign credit exposure as of December 31, 2018 was minimal and did not exceed 1% of total assets.

Maturities and Sensitivities of Loans to Changes in Interest Rates

At December 31, 2018, commercial, financial and agricultural loans were 43.1% fixed-rate and 56.9% variable-rate. Real estate construction loans were 48.0% fixed-rate and 52.0% variable-rate. Residential mortgage loans were 75.9% fixed-rate and 24.1% variable-rate. Home equity lines and loans were 5.9% fixed-rate and 94.1% variable-rate. Commercial mortgage loans were 33.1% fixed-rate and 66.9% variable-rate. Consumer loans were 81.7% fixed-rate and 18.3% variable-rate.

Commercial loans and commercial mortgage loans with variable interest rates are underwritten at the current market rate of interest. For commercial loans and commercial real estate loans with a fixed-rate period that are not fully amortizing, the loans are underwritten at the current market rate of interest. At the expiration of the fixed-rate period and/or maturity, the projected loan balance at that time is underwritten at an interest rate based on the current interest rate plus two percent per annum (2%).

Qualifying payments for our variable-rate residential mortgage loans with initial fixed-rate periods of five years or less are calculated using the greater of the note rate plus 2% per annum or the fully indexed rate. Payments for our variable-rate loans with a fixed-rate period of greater than five years are calculated using the greater of the note rate or the fully indexed rate. The qualifying payment for our HELOCs is based on the fully indexed rate plus the required principal plus interest payment due during the repayment period assuming the line was fully drawn. Our consumer lines of credit use a qualifying payment based on a percentage of the credit limit that exceeds the actual required fully indexed interest rate payment calculation.

The following table sets forth the maturity distribution and sensitivities of the loan portfolio to changes in interest rates at December 31, 2018. Maturities are based on contractual maturity dates and do not factor in principal amortization. This differs from the assumptions used in Table 21 - Interest Rate Sensitivity.

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

	Maturing			
	One Year or Less	Over One Through Five Years	Over Five Years	Total
	(Dollars in thousands)			
Commercial, financial and agricultural				
With fixed interest rates	$ 23,761	$ 118,422	$ 108,266	$ 250,449
With variable interest rates	34,481	190,323	105,924	330,728
Total commercial, financial and agricultural	58,242	308,745	214,190	581,177
Construction				
With fixed interest rates	2,000	4,484	25,836	32,320
With variable interest rates	14,621	16,120	4,208	34,949
Total construction	16,621	20,604	30,044	67,269
Residential mortgage				
With fixed interest rates	471	9,813	1,071,463	1,081,747
With variable interest rates	21	2,633	339,983	342,637
Total residential mortgage	492	12,446	1,411,446	1,424,384
Home equity				
With fixed interest rates	354	1,197	26,249	27,800
With variable interest rates	3,061	21,070	417,035	441,166
Total home equity	3,415	22,267	443,284	468,966
Commercial mortgage				
With fixed interest rates	17,311	103,007	224,143	344,461
With variable interest rates	32,972	252,329	411,923	697,224
Total commercial mortgage	50,283	355,336	636,066	1,041,685
Consumer				
With fixed interest rates	7,324	326,562	68,321	402,207
With variable interest rates	36,760	27,462	25,839	90,061
Total consumer	44,084	354,024	94,160	492,268
Leases				
With fixed interest rates	124	—	—	124
With variable interest rates	—	—	—	—
Total leases	124	—	—	124
Total loans and leases	$ 173,261	$ 1,073,422	$ 2,829,190	$ 4,075,873
All loans				
With fixed interest rates	$ 51,345	$ 563,485	$ 1,524,278	$ 2,139,108
With variable interest rates	121,916	509,937	1,304,912	1,936,765
Total loans and leases	$ 173,261	$ 1,073,422	$ 2,829,190	$ 4,075,873

Provision and Allowance for Loan and Lease Losses

As described above under the "Critical Accounting Policies and Use of Estimates" section, the Provision is determined by management's ongoing evaluation of the loan portfolio and our assessment of the ability of the Allowance to cover inherent losses. Our methodology for determining the adequacy of the Allowance and Provision takes into account many factors, including the level and trend of nonperforming and potential problem loans, net charge-off experience, current repayment by borrowers, fair value of collateral securing specific loans, changes in lending and underwriting standards and general economic factors, nationally and in the markets we serve.

The Company maintains its Allowance at an appropriate level as of a given balance sheet date to absorb management's best estimate of probable credit losses inherent in its loan portfolios that will likely be realized over various loss emergence periods. These periods are based upon management's comprehensive analysis of the risk profiles particular to the respective loan portfolios. Analysis of Allowance appropriateness is performed quarterly to coincide with financial disclosure to the public and to the regulatory agencies and is governed by a Board-approved policy and methodology.

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

Table 11. Allowance for Loan and Lease Losses

	Year Ended December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Average loans and leases outstanding	$ 3,898,250	$ 3,622,033	$ 3,385,741	$ 3,038,100	$ 2,798,826
Allowance for Loan and Lease Losses					
Balance at beginning of year	$ 50,001	$ 56,631	$ 63,314	$ 74,040	$ 83,820
Charge-offs:					
Commercial, financial and agricultural	2,852	1,704	1,599	5,658	5,268
Real estate:					
Construction	—	—	—	—	—
Residential mortgage	—	73	—	—	—
Home equity	—	—	—	110	139
Commercial mortgage	—	—	209	838	1,041
Consumer	7,323	6,294	5,054	4,650	3,481
Leases	—	—	—	—	8
Total	10,175	8,071	6,862	11,256	9,937
Recoveries:					
Commercial, financial and agricultural	1,203	1,366	2,114	4,788	2,382
Real estate:					
Construction	5,759	169	133	880	2,040
Residential mortgage	204	879	695	1,121	907
Home equity	27	44	15	1,056	85
Commercial mortgage	52	157	1,024	6,719	53
Consumer	1,969	1,500	1,715	1,610	1,096
Leases	—	—	—	27	8
Total	9,214	4,115	5,696	16,201	6,571
Net loan charge-offs (recoveries)	961	3,956	1,166	(4,945)	3,366
Provision (credit) for loan and lease losses	(1,124)	(2,674)	(5,517)	(15,671)	(6,414)
Balance at end of year	$ 47,916	$ 50,001	$ 56,631	$ 63,314	$ 74,040
Ratios:					
Allowance for loan and lease losses to loans and leases outstanding	1.17%	1.33%	1.61%	1.97 %	2.53%
Net loan charge-offs (recoveries) to average loans and leases outstanding	0.02%	0.11%	0.03%	(0.16)%	0.12%

Our Allowance at December 31, 2018 totaled $47.9 million, which represented a decrease of $2.1 million, or 4.2%, from year-end 2017. When expressed as a percentage of total loans and leases, our Allowance decreased to 1.17% at December 31, 2018, from 1.33% at year-end 2017. The decrease in our Allowance during 2018 was a result of a credit to the Provision of $1.1 million recognized during the year and $1.0 million in net charge-offs during the year. The decrease in our Allowance as a percentage of total loans and leases from year-end 2017 to year-end 2018 is consistent with our improved credit risk profile as

evidenced by a decrease in our nonperforming assets and is consistent with our belief that stabilization in our loan portfolio, the overall economy and the commercial real estate markets both in Hawaii and on the U.S. Mainland is continuing.

Our Allowance as a percentage of our nonperforming assets increased from 1,378.96% at December 31, 2017 to 1,750.68% at December 31, 2018. Our Allowance as a percentage of our nonaccrual loans increased from 1,801.84% at December 31, 2017 to 2,062.68% at December 31, 2018.

This trend was consistent with the improving credit quality as represented by nonperforming assets of $2.7 million, $3.6 million, and $9.2 million at December 31, 2018, 2017 and 2016, respectively. Net charge-offs were $1.0 million, $4.0 million, and $1.2 million, respectively, for the years ended December 31, 2018, 2017 and 2016.

The following table sets forth the allocation of the Allowance by loan category as of the dates indicated. Our practice is to make specific allocations on impaired loans and general allocations to each loan category based on management's risk assessment and estimated loss rate.

Table 12. Allocation of Allowance for Loan and Lease Losses

	December 31,									
	2018		2017		2016		2015		2014	
	Allowance for Loan and Lease Losses	Loan Category as a % of Total Loans	Allowance for Loan and Lease Losses	Loan Category as a % of Total Loans	Allowance for Loan and Lease Losses	Loan Category as a % of Total Loans	Allowance for Loan and Lease Losses	Loan Category as a % of Total Loans	Allowance for Loan and Lease Losses	Loan Category as a % of Total Loans
	(Dollars in thousands)									
Commercial, financial and agricultural	$ 8,027	14.3%	$ 7,594	13.4%	$ 8,637	14.5%	$ 6,905	16.2%	$ 8,954	15.8%
Real estate:										
Construction	1,202	1.6	1,835	1.7	4,224	2.9	8,454	2.7	14,969	3.9
Residential mortgage	14,349	35.0	14,328	35.6	15,055	34.5	14,642	35.3	15,031	36.0
Home equity	3,788	11.5	3,317	10.9	3,502	10.3	3,096	9.4	2,896	7.8
Commercial mortgage	13,358	25.5	16,801	25.9	19,104	25.1	21,847	23.7	20,869	24.0
Consumer	7,192	12.1	6,126	12.5	6,109	12.7	6,230	12.7	7,314	12.4
Leases	—	—	—	—	—	—	—	—	7	0.1
Unallocated	—	—	—	—	—	—	2,140	—	4,000	—
Total	$ 47,916	100.0%	$ 50,001	100.0%	$ 56,631	100.0%	$ 63,314	100.0%	$ 74,040	100.0%

The Allowance allocated to commercial, financial and agricultural loans totaled $8.0 million, or 1.4%, of total commercial, financial and agricultural loans at December 31, 2018, compared to $7.6 million, or 1.5%, of related loans at December 31, 2017. The increase in the ending Allowance amount was consistent with the growth in the commercial, financial and agricultural loan portfolio.

The Allowance allocated to construction loans totaled $1.2 million, or 1.8%, of total construction loans at December 31, 2018, compared to $1.8 million, or 2.9%, of construction loans outstanding at December 31, 2017. The decreases in the ending Allowance amount and the Allowance as a percentage of construction loans were due to continued improvement in credit quality of the portfolio. In 2018, the Company received a $4.5 million recovery on a U.S. mainland land loan, which is included in the construction loan category.

The Allowance allocated to our residential mortgage loans totaled $14.3 million, or 1.0%, of total residential mortgage loans at December 31, 2018, compared to $14.3 million, or 1.1%, of related loans at December 31, 2017.

The Allowance allocated to our home equity loans totaled $3.8 million, or 0.8%, of total home equity loans at December 31, 2018, compared to $3.3 million, or 0.8%, of related loans at December 31, 2017.

The Allowance allocated to commercial mortgage loans totaled $13.4 million, or 1.3%, of total commercial mortgage loans at December 31, 2018, compared to $16.8 million, or 1.7%, of related loans at December 31, 2017. The decreases in the ending Allowance amount and the Allowance as a percentage of commercial mortgage loans were due to continued improvement in credit quality of the portfolio.

The Allowance allocated to consumer loans totaled $7.2 million, or 1.5% of total consumer loans at December 31, 2018, compared to $6.1 million, or 1.3% of related loans at December 31, 2017. The increases in the ending Allowance amount and the Allowance as a percentage of consumer loans were consistent with the growth and slight increase in charge-offs in the consumer loan portfolio.

We did not allocate an Allowance for leases as of December 31, 2018 and 2017.

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

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

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

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

Table 13. Nonperforming Assets, Past Due and Restructured Loans

	December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Nonaccrual loans					
Commercial, financial and agricultural	$ —	$ —	$ 1,877	$ 1,044	$ 13,007
Real estate:					
Construction	—	—	—	—	310
Residential mortgage	2,048	2,280	5,322	5,464	12,571
Home equity	275	416	333	666	477
Commercial mortgage	—	79	864	7,094	12,722
Total nonaccrual loans	2,323	2,775	8,396	14,268	39,087
Other real estate					
Real estate:					
Construction	—	—	—	—	747
Residential mortgage	414	851	791	1,962	2,201
Commercial mortgage	—	—	—	—	—
Other real estate	414	851	791	1,962	2,948
Total nonperforming assets	2,737	3,626	9,187	16,230	42,035
Accruing loans delinquent for 90 days or more					
Real estate:					
Residential mortgage	—	49	—	—	—
Home equity	298	—	1,120	—	—
Consumer	238	515	271	273	77
Leases	—	—	—	—	—
Total accruing loans delinquent for 90 days or more	536	564	1,391	273	77
Restructured loans still accruing interest					
Commercial, financial and agricultural	220	491	—	—	361
Real estate:					
Construction	—	—	21	809	892
Residential mortgage	7,330	10,677	14,292	16,224	16,878
Home equity	—	—	—	—	967
Commercial mortgage	1,036	1,466	1,879	3,224	10,405
Total restructured loans still accruing interest	8,586	12,634	16,192	20,257	29,503

	December 31,				
	2018	2017	2016	2015	2014
	(Dollars in thousands)				
Total nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest	$ 11,859	$ 16,824	$ 26,770	$ 36,760	$ 71,615
Total nonperforming assets as a percentage of loans and leases and other real estate	0.07%	0.10%	0.26%	0.51%	1.43%
Total nonperforming assets and accruing loans delinquent for 90 days or more as a percentage of loans and leases and other real estate	0.08%	0.11%	0.30%	0.51%	1.43%
Total nonperforming assets, accruing loans delinquent for 90 days or more and restructured loans still accruing interest as a percentage of loans and leases and other real estate	0.29%	0.45%	0.76%	1.14%	2.44%
Year-to-date changes in nonperforming assets:					
Balance at beginning of year	$ 3,626	$ 9,187	$ 16,230	$ 42,035	$ 46,751
Additions	593	3,678	6,326	11,863	28,295
Reductions:					
Payments	(467)	(5,522)	(6,390)	(9,564)	(9,630)
Return to accrual status	(538)	(3,645)	(4,546)	(11,486)	(15,761)
Sales of foreclosed assets	(40)	(165)	(2,599)	(13,307)	(3,457)
Charge-offs and/or valuation adjustments	(437)	93	166	(3,311)	(4,163)
Total reductions	(1,482)	(9,239)	(13,369)	(37,668)	(33,011)
Balance at end of year	$ 2,737	$ 3,626	$ 9,187	$ 16,230	$ 42,035

Nonperforming assets, which includes nonaccrual loans and leases, nonperforming loans classified as held for sale and other real estate, totaled $2.7 million at December 31, 2018, compared to $3.6 million at December 31, 2017. Nonperforming assets at December 31, 2018 were comprised of $2.3 million in nonaccrual loans, none of which were loans classified as held for sale, and $0.4 million in other real estate.

The decline in 2018 was attributable to $0.5 million in repayments, $0.5 million in loans restored to accrual status, the sale of $40 thousand of foreclosed assets and $0.4 million in charge-offs and/or valuation adjustments. All of these decreases were offset by $0.6 million in gross additions.

Net changes to nonperforming assets by category during 2018 included net decreases in Hawaii residential mortgage assets totaling $0.6 million, Hawaii home equity assets totaling $0.1 million, and Hawaii commercial mortgage assets totaling $0.1 million.

Loans delinquent for 90 days or more still accruing interest totaled $0.5 million at December 31, 2018, compared to $0.6 million at December 31, 2017.

Investment Portfolio

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

Table 14. Distribution of Investment Securities

	December 31,								
	2018			2017			2016		
	Held-to-Maturity (Amortized Cost)	Available-for-Sale (Fair Value)	Equity Securities (Fair Value)	Held-to-Maturity (Amortized Cost)	Available-for-Sale (Fair Value)	Equity Securities (Fair Value)	Held-to-Maturity (Amortized Cost)	Available-for-Sale (Fair Value)	Equity Securities (Fair Value)
	(Dollars in thousands)								
Debt securities:									
States and political subdivisions	$ —	$ 173,674	$ —	$ —	$ 179,781	$ —	$ —	$ 185,041	$ —
Corporate securities	—	54,849	—	—	74,278	—	—	99,389	—
U.S. Treasury obligations and direct obligations of U.S Government agencies	—	32,574	—	—	25,510	—	—	—	—
Mortgage-backed securities:									
Residential - U.S. government-sponsored entities ("GSEs")	83,436	717,052	—	100,279	800,683	—	124,082	769,986	—
Residential - Non-government sponsored entities ("Non-GSEs")	—	41,118	—	—	46,763	—	—	51,547	—
Commercial - U.S. GSEs and agencies	65,072	51,483	—	91,474	39,725	—	93,586	—	—
Commercial - Non-GSEs	—	134,728	—	—	137,326	—	—	137,224	—
Equity securities	—	—	826	—	—	825	—	—	660
Total	$ 148,508	$1,205,478	$ 826	$ 191,753	$1,304,066	$ 825	$ 217,668	$1,243,187	$ 660

Investment securities totaled $1.35 billion at December 31, 2018, decreasing by $141.8 million, or 9.5%, from the $1.50 billion held at December 31, 2017, which increased by $35.1 million, or 2.40%, from the $1.46 billion at year-end 2016.

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

In the second quarter of 2015, $119.4 million in available-for-sale agency securities were sold as part of an investment portfolio repositioning strategy designed to improve our interest rate risk profile. We received $117.5 million in gross proceeds and reinvested the proceeds in $120.6 million in mortgage-backed securities yielding an average of 2.71% at an average weighted life of 7.6 years. Gross realized losses on the sales of the available-for-sale investment securities were $1.9 million. The investment securities sold had an average net yield of 1.35% and a weighted average life of 4.4 years. The specific identification method was used as the basis for determining the cost of all securities sold.

Maturity Distribution of Investment Portfolio

The following table sets forth the maturity distribution of the investment portfolio and weighted average yields by investment type and maturity grouping at December 31, 2018.

Table 15. Maturity Distribution of Investment Portfolio

Portfolio Type and Maturity Grouping	Carrying Value	Weighted Average Yield (1)
	(Dollars in thousands)	
Held-to-maturity portfolio:		
Residential mortgage-backed securities - U.S. government-sponsored entities ("GSEs"):		
Within one year	$ —	—%
After one but within five years	—	—
After five but within ten years	11,197	1.65
After ten years	72,239	2.29
Total residential mortgage-backed securities - U.S. GSEs	83,436	2.20
Commercial mortgage-backed securities - U.S. GSEs:		
Within one year	—	—
After one but within five years	65,072	2.07
After five but within ten years	—	—
After ten years	—	—
Total commercial mortgage-backed securities - U.S. GSEs	65,072	2.07
Total held-to-maturity portfolio	$ 148,508	2.14%
Available-for-sale portfolio:		
Debt securities - States and political subdivisions:		
Within one year	$ 47,659	2.92%
After one but within five years	57,630	2.59
After five but within ten years	39,129	3.31
After ten years	29,256	3.63
Total debt securities - States and political subdivisions	173,674	3.02
Debt securities - Corporate:		
Within one year	17,827	2.57
After one but within five years	37,022	2.79
After five but within ten years	—	—
After ten years	—	—
Total debt securities - Corporate	54,849	2.72
Debt securities - U.S. Treasury obligations and direct obligations of U.S Government agencies:		
Within one year	—	—
After one but within five years	—	—
After five but within ten years	8,680	3.10
After ten years	23,894	3.25
Total debt securities - U.S. Treasury obligations and direct obligations of U.S Government agencies	32,574	3.21
Residential mortgage-backed securities - U.S. GSEs:		
Within one year	—	—

Portfolio Type and Maturity Grouping	Carrying Value	Weighted Average Yield (1)
	(Dollars in thousands)	
After one but within five years	3,932	2.69
After five but within ten years	70,650	2.25
After ten years	642,470	2.78
Total residential mortgage-backed securities - U.S. GSEs	717,052	2.72
Residential mortgage-backed securities - Non-government sponsored entities ("Non-GSEs"):		
Within one year	—	—
After one but within five years	—	—
After five but within ten years	—	—
After ten years	41,118	3.36
Total residential mortgage-backed securities - Non-GSEs	41,118	3.36
Commercial mortgage-backed securities - U.S. GSEs and agencies:		
Within one year	—	—
After one but within five years	—	—
After five but within ten years	47,004	2.87
After ten years	4,479	2.84
Total commercial mortgage-backed securities - U.S. GSEs and agencies	51,483	2.87
Commercial mortgage-backed securities - Non-GSEs:		
Within one year	—	—
After one but within five years	114,836	3.08
After five but within ten years	19,892	4.12
After ten years	—	—
Total commercial mortgage-backed securities - Non-GSEs	134,728	3.24
Total available-for-sale portfolio	$ 1,205,478	2.86%
Equity securities:		
Within one year	$ —	—%
After one but within five years	—	—
After five but within ten years	—	—
After ten years	826	—
Total equity securities	826	—
Total investment securities	$ 1,354,812	2.78%

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

As of December 31, 2018, the weighted average yield of the investment portfolio of 2.78% increased by 15 bp from 2.63% in the prior year.

Deposits

The primary source of our funding comes from deposits in the state of Hawaii. In this competitive market, we strive to distinguish ourselves by providing exceptional customer service in our branch offices and establishing long-term relationships with businesses and their principals. Our focus has been to develop a large, stable base of core deposits, which are comprised of non-interest bearing and interest-bearing demand deposits, savings and money market deposits, and time deposits less than $100,000. Time deposits in amounts of $100,000 and greater are generally considered to be more price-sensitive than relationship-based and are thus given less focus in our marketing and sales efforts.

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

Table 16. Deposits by Categories

	December 31,				
	2018	**2017**	**2016**	**2015**	**2014**
			(Dollars in thousands)		
Noninterest-bearing demand deposits	$ 1,436,967	$ 1,395,556	$ 1,265,246	$ 1,145,244	$ 1,034,146
Interest-bearing demand deposits	954,011	933,054	862,991	824,895	788,272
Savings and money market deposits	1,448,257	1,481,876	1,390,600	1,399,093	1,242,598
Time deposits less than $100,000	176,707	180,748	194,730	212,946	241,117
Core deposits	4,015,942	3,991,234	3,713,567	3,582,178	3,306,133
Government time deposits	631,293	687,052	701,417	664,756	600,504
Other time deposits $100,000 to $250,000	106,783	101,560	103,720	114,083	128,518
Other time deposits greater than $250,000	192,472	176,508	89,497	72,422	75,145
Total time deposits $100,000 and greater	930,548	965,120	894,634	851,261	804,167
Total deposits	$ 4,946,490	$ 4,956,354	$ 4,608,201	$ 4,433,439	$ 4,110,300

Total deposits of $4.95 billion at December 31, 2018 reflected a decrease of $9.9 million, or 0.2%, from total deposits of $4.96 billion at December 31, 2017. Total deposits at December 31, 2017 increased by $348.2 million, or 7.6%, over the year-end 2016 balance of $4.61 billion. The decrease in deposits in 2018 reflects net decreases in government time deposits of $55.8 million, savings and money market deposits of $33.6 million, and time deposits less than $100,000 of $4.0 million. The net decreases were partially offset by increases in and noninterest-bearing demand deposits of $41.4 million, interest-bearing demand deposits of $21.0 million, other time deposits greater than $100,000 (excluding government time deposits) totaling $21.2 million. In 2018, Federal Home Loan Bank advances were used to replace government time deposits and fund loan growth.

Core deposits totaled $4.02 billion at December 31, 2018 and increased by $24.7 million, or 0.6%, from December 31, 2017, which increased by $277.7 million or 7.5% from December 31, 2016. Core deposits as a percentage of total deposits was 81.2% at December 31, 2018, compared to 80.5% at December 31, 2017 and 80.6% at December 31, 2016. For additional information regarding the contractual maturities of our time deposits, See Note 10 - Deposits to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data."

The table below sets forth information regarding the average balances and average rates paid for certain deposit categories for each of the years indicated. Average balances are computed using daily average balances. The average rate on time deposits, which are most sensitive to changes in market rates, increased by 59 bp in 2018, while savings and money market deposit rates and interest-bearing demand deposit rates increased by 5 by and 1 bp, respectively. The average rate paid on all deposits increased 16 bp to 0.39% in 2018 from 0.23% in 2017, which increased from 0.12% in 2016.

Table 17. Average Balances and Average Rates on Deposits

	Year Ended December 31,					
	2018		2017		2016	
	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid	Average Balance	Average Rate Paid
	(Dollars in thousands)					
Noninterest-bearing demand deposits	$ 1,385,427	—%	$ 1,325,583	—%	$ 1,156,906	—%
Interest-bearing demand deposits	936,034	0.08	901,171	0.07	844,507	0.06
Savings and money market deposits	1,494,658	0.13	1,449,379	0.08	1,406,754	0.07
Time deposits	1,194,579	1.40	1,173,020	0.81	1,084,929	0.38
Total	$ 5,010,698	0.39	$ 4,849,153	0.23	$ 4,493,096	0.12

In its first meeting in January 2019, the Federal Reserve opted not to raise interest rates and pledged future moves will be done patiently and with an eye toward how global economic and financial developments unfold. We expect overall deposit rates to hold relatively steady in 2019 based on the Federal Open Market Committee's recent statements. In addition to the external interest rate environment, the overall direction and magnitude of rate movements in our deposit base will largely depend on the level of deposit growth we need to maintain adequate liquidity and competitive pricing considerations.

Contractual Obligations

The following table sets forth contractual obligations (excluding deposit liabilities) as of December 31, 2018.

Table 18. Contractual Obligations

	Payments Due By Period				
	Less Than One Year	1-3 Years	3-5 Years	More Than 5 Years	Total
	(Dollars in thousands)				
Short-term borrowings	$ 197,000	$ —	$ —	$ —	$ 197,000
Long-term debt	20,619	50,000	—	51,547	122,166
Pension plan and SERP obligations	2,121	4,111	3,863	21,006	31,101
Operating leases	6,667	11,604	8,030	17,423	43,724
Purchase obligations	27,086	18,449	13,428	4,696	63,659
Other long-term liabilities	4,634	3,560	20	70	8,284
Total	$ 258,127	$ 87,724	$ 25,341	$ 94,742	$ 465,934

Components of short-term borrowings and long-term debt are discussed in Note 11 - Short-Term Borrowings and Note 12 - Long-Term Debt, respectively, to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data." Pension plan obligations include obligations under our defined benefit retirement plan and Supplemental Executive Retirement Plans, which are discussed in Note 17 - Pension Plans to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data." Operating leases represent leases on bank premises as discussed in Note 19 - Operating Leases to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data." Purchase obligations represent other contractual obligations to purchase goods or services at specified terms including, but not limited to, software licensing agreements, equipment maintenance contracts and professional service contracts. Other long-term liabilities represent expected payments for unfunded commitments related to our investments in LIHTC partnerships.

Contractual obligations in Table 18 - Contractual Obligations do not include off-balance sheet arrangements. These financial instruments include commitments to extend credit, standby letters of credit and financial guarantees written, forward foreign exchange contracts, forward interest rate contracts and interest rate swaps and options. These instruments and the related off-balance sheet exposures are discussed in detail in Note 24 - Financial Instruments With Off-Balance Sheet Risk to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data."

Capital Resources

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

Common and Preferred Equity

Shareholders' equity totaled $491.7 million at December 31, 2018, a decrease of $8.3 million, or 1.7%, from the $500.0 million at December 31, 2017, which decreased by $4.6 million, or 0.9%, from December 31, 2016. When expressed as a percentage of total assets, shareholders' equity was 8.5% at December 31, 2018, compared to 8.9% at December 31, 2017 and 9.4% at December 31, 2016.

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

The decrease in shareholders' equity from December 31, 2016 to December 31, 2017 was primarily attributable to net income in 2017 of $41.2 million, partially offset by: 1) the repurchase of 864,483 shares of our common stock for a total cost of $26.6 million, under our stock repurchase program, and 2) cash dividends paid of $21.3 million. During 2017 we repurchased approximately 2.8% of our common stock outstanding at December 31, 2016.

Our tangible common equity ratio was 8.47% at December 31, 2018, compared to 8.86% at December 31, 2017 and 9.29% at December 31, 2016. Our book value per share was $16.97, $16.65, and $16.39 at year-end 2018, 2017 and 2016, respectively. The decrease in our tangible common equity ratio in 2018 from 2017 was primarily attributable to the reduction in our common equity due to common stock repurchases completed in 2018, as well as the quarterly dividends paid in 2018. The increase in our book value per share from 2017 was primarily attributable to net income recorded in 2018 of $59.5 million, combined with the reduction in common shares outstanding due to the aforementioned common stock repurchases completed in 2018.

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

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

Table 19. Reconciliation to Tangible Common Equity Ratio

	December 31,		
	2018	2017	2016
	(Dollars in thousands)		
Total shareholders’ equity	$ 491,725	$ 500,011	$ 504,650
Less:			
Other intangible assets (core deposit premium)	—	(2,006)	(4,680)
Tangible common equity	$ 491,725	$ 498,005	$ 499,970
Total assets	$ 5,807,026	$ 5,623,708	$ 5,384,236
Less: Other intangible assets (core deposit premium)	—	(2,006)	(4,680)
Tangible assets	$ 5,807,026	$ 5,621,702	$ 5,379,556
Tangible common equity to tangible assets	8.47%	8.86%	9.29%

Trust Preferred Securities

We have four statutory trusts, CPB Capital Trust II ("Trust II"), CPB Statutory Trust III ("Trust III"), CPB Capital Trust IV ("Trust IV") and CPB Statutory Trust V ("Trust V"), which issued a total of $90.0 million in trust preferred securities. We previously had CPB Capital Trust I ("Trust I"), which was canceled in August 2014. Our obligations with respect to the issuance of the trust preferred securities constitute a full and unconditional guarantee by the Company of the 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.

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

On December 17, 2018, the Company completed the redemption of $20.0 million in floating rate trust preferred securities of Trust III bearing an interest rate of three-month LIBOR plus 2.85% and maturing on December 17, 2033. The redemption price was 100% of the aggregate liquidation amount of the securities plus accumulated but unpaid distributions up to but not including the redemption date. The Company also redeemed $0.6 million of common securities issued by Trust III and held by the Company, as a result of the concurrent redemption of 100% of the principal assets of Trust III, or $20.6 million of the Company's junior subordinated debentures with an identical interest rate and maturity as the Trust III trust preferred securities. The redemption was pursuant to the optional prepayment provisions of the indenture. On January 9, 2019, Trust III was canceled with the state of Connecticut.

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

Holding Company Capital Resources

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

CPF relies on the bank to pay dividends to it to fund its obligations. As of December 31, 2018, on a stand-alone basis, CPF had an available cash balance of approximately $16.7 million in order to meet its ongoing obligations.

As a Hawaii state-chartered bank, the bank may only pay dividends to the extent it has retained earnings as defined under Hawaii banking law ("Statutory Retained Earnings"), which differs from GAAP retained earnings. As of December 31, 2018, the bank had Statutory Retained Earnings of $46.6 million.

Dividends are payable at the discretion of the Board of Directors and there can be no assurance that the Board of Directors will continue to pay dividends at the same rate, or at all, in the future. Our ability to pay cash dividends to our shareholders is subject to restrictions under federal and Hawaii law, including restrictions imposed by the FRB and covenants set forth in various agreements we are a party to, including covenants set forth in our subordinated debentures. For further information, see the "Dividends — Market for Registrant's Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities" section.

Share Repurchases

We repurchase shares of our common stock when we believe such repurchases are in the best interests of the Company and our shareholders. On May 20, 2014, our Board of Directors authorized the repurchase and retirement of up to $30.0 million of the Company's outstanding common stock (the "2014 Repurchase Plan"). In January 2015, our Board of Directors increased our repurchase authority under the 2014 Repurchase Plan by $25.0 million. In March, 2015, our Board of Directors increased the

authorization under the 2014 Repurchase Plan by an additional $75.0 million. In 2015, we repurchased 4,122,881 shares of common stock, at a cost of $93.5 million, excluding fees and expenses, under the 2014 Repurchase Plan.

In January 2016, our 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"). The 2016 Repurchase Plan replaced and superseded in its entirety the 2014 Repurchase Plan. In 2016, 796,822 shares of common stock, at a cost of $18.2 million, were repurchased under this program. A total of $11.8 million authorized remained available for repurchase under the 2016 Repurchase Plan at December 31, 2016.

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

In November 2017, the Board of Directors authorized an increase in the 2017 Repurchase Plan authority by an additional $50.0 million (known henceforth as the "Repurchase Plan"). In 2017, 864,483 shares of common stock, at a cost of $26.6 million, were repurchased under the 2016 Repurchase Plan and the Repurchase Plan combined.

In 2018, 1,155,157 shares of common stock, at a cost of $32.8 million, were repurchased under the Repurchase Plan. A total of $20.7 million remained available for repurchase under the Repurchase Plan at December 31, 2018. There is no expiration date on the Repurchase Plan. Our ability to repurchase shares is subject to the discretion of our Board of Directors and approval of our regulators, and there can be no assurance that the Board will repurchase shares of our common stock in the future.

Cybersecurity

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

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

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

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

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

Transaction Risk

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

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

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

Compliance Risk

Compliance risk is the risk to earnings or capital arising from violations of, or non-conformance with, laws, rules, regulations, prescribed practices, or ethical standards. Compliance risk also arises in situations where the laws or rules governing certain products or activities of the bank's customers may be ambiguous or untested. Compliance risk exposes us to fines, civil money penalties, payment of damages, and the voiding of contracts. Compliance risk can also lead to a diminished reputation, reduced business value, limited business opportunities, lessened expansion potential, and lack of contract enforceability. The Company utilizes independent external firms to conduct compliance audits as a means of identifying weaknesses in the compliance program.

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

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

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

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

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

Strategic Risk

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

Strategic risks are identified as part of the strategic planning process. Offsite strategic planning sessions, with members of the

Board of Directors and Executive Committee, are held annually. The strategic review consists of an economic assessment, competitive analysis, industry outlook and legislative and regulatory review.

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

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

Asset/Liability Management and Interest Rate Risk

Our earnings and capital are sensitive to risk of interest rate fluctuations. Interest rate risk arises when rate-sensitive assets and rate-sensitive liabilities mature or reprice during different periods or in differing amounts. In the normal course of business, we are subjected to interest rate risk through the activities of making loans and taking deposits, as well as from our investment securities portfolio and other interest-bearing funding sources. Asset/liability management attempts to coordinate our rate-sensitive assets and rate-sensitive liabilities to meet our financial objectives.

Our Asset/Liability Management Policy seeks to maximize the risk-adjusted return to shareholders while maintaining consistently acceptable levels of liquidity, interest rate risk and capitalization. Our Asset/Liability Management Committee, or ALCO, monitors interest rate risk through the use of interest rate sensitivity gap, net interest income and market value of portfolio equity simulation and rate shock analyses. This process is designed to measure the impact of future changes in interest rates on net interest income and market value of portfolio equity. Adverse interest rate risk exposures are managed through the shortening or lengthening of the duration of assets and liabilities.

Interest rate risk can be analyzed by monitoring an institution's interest rate sensitivity gap and changes in the gap over time. An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or reprice within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets and the amount of interest-bearing liabilities maturing or repricing within a specified time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. During a period of rising interest rates, the earnings of an institution with a positive gap theoretically may be positively affected due to its interest-earning assets repricing to a greater extent than its interest-bearing liabilities. An adverse impact would be expected for an institution with a negative gap.

The following table sets forth information regarding our interest rate sensitivity gap at December 31, 2018. The assumptions used in determining interest rate sensitivity of various asset and liability products had a significant impact on the resulting table. For purposes of this presentation, assets and liabilities are classified by the earliest repricing date or maturity. All interest-bearing demand and savings balances are included in the three-months-or-less category, even though repricing of these accounts is not contractually required and may not actually occur during that period. Since all interest rates and yields do not adjust at the same velocity or magnitude, and since volatility is subject to change, the interest rate sensitivity gap is only a general indicator of interest rate risk.

Table 20. Rate Sensitivity of Assets, Liabilities and Equity

	Three Months or Less	Over Three Through Six Months	Over Six Through Twelve Months	Over One Through Three Years	Over Three Years	Non-Rate Sensitive	Total
	(Dollars in thousands)						
Assets							
Interest-bearing deposits in other financial institutions	$ 21,617	$ —	$ —	$ —	$ —	$ —	$ 21,617
Investment securities	80,972	57,508	86,415	326,460	802,631	826	1,354,812
Loans held for sale	6,596	—	—	—	—	51	6,647
Loans and leases	967,451	301,670	446,539	1,182,082	1,178,131	2,493	4,078,366
Federal Home Loan Bank stock	16,645	—	—	—	—	—	16,645
Other assets	—	—	—	—	—	328,939	328,939
Total assets	$ 1,093,281	$ 359,178	$ 532,954	$ 1,508,542	$ 1,980,762	$ 332,309	$ 5,807,026
Liabilities and Equity							
Noninterest-bearing deposits	$ 1,436,967	$ —	$ —	$ —	$ —	$ —	$ 1,436,967
Interest-bearing deposits	3,041,606	155,133	169,026	119,382	24,376	—	3,509,523
Federal Home Loan Bank advances and other short-term borrowings	197,000	—	—	—	—	—	197,000
Long-term debt	72,166	—	—	50,000	—	—	122,166
Other liabilities	—	—	—	—	—	49,645	49,645
Equity	—	—	—	—	—	491,725	491,725
Total liabilities and equity	$ 4,747,739	$ 155,133	$ 169,026	$ 169,382	$ 24,376	$ 541,370	$ 5,807,026
Interest rate sensitivity gap	$ (3,654,458)	$ 204,045	$ 363,928	$ 1,339,160	$ 1,956,386	$ (209,061)	$ —
Cumulative interest rate sensitivity gap	$ (3,654,458)	$ (3,450,413)	$ (3,086,485)	$ (1,747,325)	$ 209,061	$ —	$ —

ALCO also utilizes a detailed and dynamic simulation model to measure and manage interest rate risk exposures. The monthly simulation process is designed to measure the impact of future changes in interest rates on net interest income and market value of portfolio equity and to allow ALCO to model alternative balance sheet strategies.

The following reflects our net interest income sensitivity analysis as of December 31, 2018, over a one-year horizon, assuming no balance sheet growth and given both a 100 bp upward and 100 bp downward parallel shift in interest rates.

Rate Change	Estimated Net Interest Income Sensitivity
+100bp	1.37 %
-100bp	(3.34)%

The table below presents information on financial instruments held that are sensitive to changes in interest rates. For purposes of this presentation, expected maturities of interest-sensitive assets and liabilities are contractual maturities. Interest-bearing

demand and savings deposits, which have indeterminate maturities, are included in the earliest maturity category. The resulting table is based on numerous assumptions including prepayment rates on mortgage-related assets and forecasted market interest rates. This differs from the assumptions used in Table 10 - Maturity Distribution and Sensitivities of Loans to Changes in Interest Rates. See Note 25 - Fair Value of Financial Assets and Financial Liabilities to the Consolidated Financial Statements under "Part II, Item 8. Financial Statements and Supplementary Data" for a discussion of the calculation of fair values.

Maturities and fair values of interest-sensitive assets and liabilities may vary from expectation if actual experience differs from the assumptions used.

Table 21. Interest Rate Sensitivity

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	Expected Maturity Within							
	One Year	**Two Years**	**Three Years**	**Four Years**	**Five Years**	**Thereafter**	**Total Book Value**	**Total Fair Value**
	(Dollars in thousands)							
Interest-sensitive assets								
Interest-bearing deposits in other financial institutions	$ 21,617	$ —	$ —	$ —	$ —	$ —	$ 21,617	$ 21,617
Weighted average yields	2.40%	0.00%	0.00%	0.00%	0.00%	0.00%	2.40%	
Fixed-rate investment securities	$ 192,257	$ 186,730	$ 139,750	$ 192,463	$ 107,974	$ 502,238	$ 1,321,412	$ 1,317,176
Weighted average yields	2.65%	2.76%	2.82%	2.64%	2.66%	2.79%	2.71%	
Variable-rate investment securities	$ 2,932	$ 2,668	$ 2,428	$ 2,209	$ 2,010	$ 20,327	$ 32,574	$ 32,574
Weighted average yields	3.21%	3.21%	3.21%	3.21%	3.21%	3.21%	3.21%	
Equity investment securities	$ —	$ —	$ —	$ —	$ —	$ 826	$ 826	$ 826
Weighted average yields	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	
Fixed-rate loans and leases	$ 561,655	$ 411,174	$ 312,830	$ 213,565	$ 153,108	$ 529,915	$ 2,182,247	$ 2,090,742
Weighted average yields	4.14%	4.09%	3.92%	4.03%	4.08%	3.95%	4.04%	
Variable-rate loans and leases	$ 707,687	$ 359,982	$ 262,550	$ 184,876	$ 167,608	$ 217,519	$ 1,900,222	$ 1,854,285
Weighted average yields	4.67%	3.95%	3.92%	3.83%	3.84%	3.64%	4.16%	
Total - December 31, 2018	$ 1,486,148	$ 960,554	$ 717,558	$ 593,113	$ 430,700	$ 1,270,825	$ 5,458,898	$ 5,317,220
Total - December 31, 2017	$ 1,379,326	$ 968,023	$ 762,556	$ 538,773	$ 498,915	$		