BANK OF HAWAII CORP
Form 10-Q
July 25, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2011

or

o Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from ______ to ______

Commission File Number: 1-6887

BANK OF HAWAII CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**99-0148992**

(State of incorporation)	(I.R.S. Employer Identification No.)
130 Merchant Street, Honolulu, Hawaii (Address of principal executive offices)	**96813** (Zip Code)

1-888-643-3888

(Registrant s telephone number, including area code)

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

Yes x No o

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

Yes x No o

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

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

As of July 18, 2011, there were 47,119,416 shares of common stock outstanding.

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Bank of Hawaii Corporation

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Bank of Hawaii Corporation and Subsidiaries

Consolidated Statements of Income (Unaudited)

(in thousands, except per share and share amounts)	Three Months Ended June 30, 2011	2010	Six Months Ended June 30, 2011	2010
Interest Income				
Interest and Fees on Loans and Leases	$ 65,542	$ 71,997	$ 132,135	$ 149,268
Income on Investment Securities				
Available-for-Sale	23,490	44,989	61,159	88,830
Held-to-Maturity	20,553	1,700	28,186	3,563
Deposits	2	3	-	16
Funds Sold	297	396	548	705
Other	279	277	558	554
Total Interest Income	110,163	119,362	222,586	242,936
Interest Expense				
Deposits	4,792	7,930	10,024	16,237
Securities Sold Under Agreements to Repurchase	7,338	6,472	14,379	12,901
Funds Purchased	5	6	11	13
Long-Term Debt	529	1,026	976	2,204
Total Interest Expense	12,664	15,434	25,390	31,355
Net Interest Income	97,499	103,928	197,196	211,581
Provision for Credit Losses	3,600	15,939	8,291	36,650
Net Interest Income After Provision for Credit Losses	93,899	87,989	188,905	174,931
Noninterest Income				
Trust and Asset Management	11,427	11,457	23,233	23,165
Mortgage Banking	2,661	3,752	5,783	7,216
Service Charges on Deposit Accounts	9,375	14,856	19,307	28,670
Fees, Exchange, and Other Service Charges	16,662	15,806	31,607	30,310
Investment Securities Gains, Net	-	14,951	6,084	34,972
Insurance	3,210	2,291	5,981	5,006
Other	6,128	5,761	11,390	11,317
Total Noninterest Income	49,463	68,874	103,385	140,656
Noninterest Expense				
Salaries and Benefits	46,800	47,500	93,582	92,064
Net Occupancy	10,476	10,154	20,803	20,298
Net Equipment	4,741	4,366		

Three Months Ended June 30, 2010					
Net Interest Income	$ 48,246	$ 36,319	$ 4,215	$ 15,148	$ 103,928
Provision for Credit Losses	9,871	6,206	(127)	(11)	15,939
Net Interest Income After Provision for Credit Losses	38,375	30,113	4,342	15,159	87,989
Noninterest Income	25,806	11,697	14,310	17,061	68,874
Noninterest Expense	(43,436)	(24,977)	(15,553)	(1,952)	(85,918)
Income Before Provision for	20,745	16,833	3,099	30,268	70,945

Income Taxes					
Provision for Income Taxes	(7,676)	(6,322)	(1,147)	(9,236)	(24,381)
Net Income	$ 13,069	$ 10,511	$ 1,952	$ 21,032	$ 46,564
Total Assets as of June 30, 2010	$ 3,156,403	$ 2,326,589	$ 312,676	$ 7,060,177	$ 12,855,845
Six Months Ended June 30, 2011					
Net Interest Income	$ 88,314	$ 69,689	$ 7,655	$ 31,538	$ 197,196
Provision for Credit Losses	10,628	209	(140)	(2,406)	8,291
Net Interest Income After Provision for Credit Losses	77,686	69,480	7,795	33,944	188,905
Noninterest Income	41,817	18,798	30,284	12,486	103,385
Noninterest Expense	(96,244)	(48,581)	(30,447)	(4,584)	(179,856)
Income Before Provision for Income Taxes	23,259	39,697	7,632	41,846	112,434
Provision for Income Taxes	(8,606)	(13,806)	(2,824)	(9,690)	(34,926)
Net Income	$ 14,653	$ 25,891	$ 4,808	$ 32,156	$ 77,508
Total Assets as of June 30, 2011	$ 3,058,041	$ 2,266,089	$ 221,347	$ 7,615,727	$ 13,161,204
Six Months Ended June 30, 2010					
Net Interest Income	$ 97,551	$ 77,446	$ 8,538	$ 28,046	$ 211,581
Provision for Credit Losses	25,227	11,347	88	(12)	36,650
Net Interest Income After Provision for Credit Losses	72,324	66,099	8,450	28,058	174,931
Noninterest Income	49,273	21,715	29,337	40,331	140,656
Noninterest Expense	(85,769)	(48,839)	(29,598)	(3,418)	(167,624)
Income Before Provision for Income Taxes	35,828	38,975	8,189	64,971	147,963
Provision for Income Taxes	(13,256)	(14,321)	(3,031)	(18,055)	(48,663)
Net Income	$ 22,572	$ 24,654	$ 5,158	$ 46,916	$ 99,300
Total Assets as of June 30, 2010	$ 3,156,403	$ 2,326,589	$ 312,676	$ 7,060,177	$ 12,855,845

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Note 9. Pension Plans and Postretirement Benefit Plan

The components of net periodic benefit cost for the Company s pension plans and the postretirement benefit plan for the three and six months ended June 30, 2011 and 2010 were as follows:

	Pension Benefits		Postretirement Benefits	
(dollars in thousands)	**2011**	**2010**	**2011**	**2010**
Three Months Ended June 30,				
Service Cost	$ -	$ -	$ 123	$ 117
Interest Cost	1,305	1,294	359	440
Expected Return on Plan Assets	(1,612)	(1,642)	-	-
Amortization of:				
Prior Service Credit	-	-	(53)	(53)
Net Actuarial Losses (Gains)	830	724	-	(76)
Net Periodic Benefit Cost	$ 523	$ 376	$ 429	$ 428
Six Months Ended June 30,				
Service Cost	$ -	$ -	$ 246	$ 234
Interest Cost	2,610	2,588	719	879
Expected Return on Plan Assets	(3,225)	(3,284)	-	-
Amortization of:				
Prior Service Credit	-	-	(106)	(106)
Net Actuarial Losses (Gains)	1,661	1,447	(1)	(152)
Net Periodic Benefit Cost	$ 1,046	$ 751	$ 858	$ 855

The net periodic benefit cost for the Company s pension plans and postretirement benefit plan are recorded as a component of salaries and benefits in the consolidated statements of income. For the three and six months ended June 30, 2011, the Company contributed $0.1 million and $0.2 million, respectively, to the pension plans. For the three and six months ended June 30, 2011, the Company contributed $0.2 million and $0.4 million, respectively, to the postretirement benefit plan. The Company expects to contribute $0.5 million to the pension plans and $1.5 million to the postretirement benefit plan for the year ending December 31, 2011.

Note 10. Derivative Financial Instruments

The following table presents the Company s derivative financial instruments, their fair values, and balance sheet location as of June 30, 2011 and December 31, 2010:

	June 30, 2011		December 31, 2010	
Derivative Financial Instruments Not Designated as Hedging Instruments1 (dollars in thousands)	**Asset Derivatives**	**Liability Derivatives**	**Asset Derivatives**	**Liability Derivatives**
Interest Rate Lock Commitments	$ 681	$ 31	$ 1,531	$ 1,648
Forward Commitments	171	45	3,114	155
Interest Rate Swap Agreements	26,637	26,855	25,982	26,197
Foreign Exchange Contracts	223	22	264	106

Total	$ 27,712	$ 26,953	$ 30,891	$ 28,106

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

The following table presents the Company s derivative financial instruments and the amount and location of the net gains and losses recognized in the statements of income for the three and six months ended June 30, 2011 and 2010:

Derivative Financial Instruments Not Designated as Hedging Instruments (dollars in thousands)	**Location of Net Gains (Losses) Recognized in the Statements of Income**	**Three Months Ended June 30,**		**Six Months Ended June 30,**	
		2011	**2010**	**2011**	**2010**
Interest Rate Lock Commitments	Mortgage Banking	$ 1,908	$ 4,886	$ 3,389	$ 7,245
Forward Commitments	Mortgage Banking	(341)	(1,689)	(105)	(2,008)
Interest Rate Swap Agreements	Other Noninterest Income	339	(41)	367	113
Foreign Exchange Contracts	Other Noninterest Income	743	667	1,640	1,413
Total		$ 2,649	$ 3,823	$ 5,291	$ 6,763

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

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

Derivative financial instruments are required to be carried at their fair value on the Company s consolidated statements of condition. As of June 30, 2011 and December 31, 2010, the Company did not designate any derivative financial instruments as formal hedging relationships. The Bank s free-standing derivative financial instruments have been recorded at fair value on the Company s consolidated statements of condition. These financial instruments have been limited to interest rate lock commitments, forward commitments, interest rate swap agreements, and foreign exchange contracts.

The Company enters into interest rate lock commitments for residential mortgage loans that the Company intends to sell in the secondary market. Interest rate exposure from interest rate lock commitments is economically hedged with forward commitments for the future sale of residential mortgage loans. The interest rate lock commitments and forward commitments are free-standing derivatives which are carried at fair value with changes recorded in the mortgage banking component of noninterest income in the Company s consolidated statements of income. Changes in the fair value of interest rate lock commitments and forward commitments subsequent to inception are based on changes in the fair value of the underlying loan resulting from the fulfillment of the commitment and changes in the probability that the loan will fund within the terms of the commitment, which is affected primarily by changes in interest rates and the passage of time.

The Company enters into interest rate swap agreements to facilitate the risk management strategies of a small number of commercial banking customers. The Company mitigates this risk by entering into equal and offsetting interest rate swap agreements with highly rated third party financial institutions. The interest rate swap agreements are free-standing derivatives which are carried at fair value with changes included in other noninterest income in the Company s consolidated statements of income. The Company is party to master netting arrangements with its institutional counterparties; however, the Company does not offset assets and liabilities under these arrangements for financial statement presentation. Collateral, usually in the form of marketable securities, is posted by the counterparty with liability positions in accordance with contract thresholds. As of June 30, 2011, the Company had net liability positions with its financial institution counterparties totaling $26.9 million. The collateral posted by the Company for these net liability positions was not material.

The Company s interest rate swap agreements with institutional counterparties contain credit-risk-related contingent features relating to the Company s debt ratings or capitalization levels. Under these provisions, if the Company s debt rating falls below investment grade or if the Company s capitalization levels fall below stipulated thresholds, certain counterparties may require immediate and ongoing collateralization on interest rate swaps in net liability positions, or may require immediate settlement of the contracts. The Company maintains debt ratings and capital levels that exceed these minimum requirements.

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

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Note 11. Credit Commitments

The Company s credit commitments as of June 30, 2011 and December 31, 2010 were as follows:

(dollars in thousands)		June 30, 2011		December 31, 2010
Unfunded Commitments to Extend Credit	$	1,822,387	$	1,875,459
Standby Letters of Credit		90,190		97,708
Commercial Letters of Credit		24,335		24,658
Total Credit Commitments	$	1,936,912	$	1,997,825

Unfunded Commitments to Extend Credit

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

Standby and Commercial Letters of Credit

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

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Note 12. Fair Value of Assets and Liabilities

Fair Value Hierarchy

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

Level 1: Inputs to the valuation methodology are quoted prices, unadjusted, for identical assets or liabilities in active markets. A quoted price in an active market provides the most reliable evidence of fair value and shall be used to measure fair value whenever available. A contractually binding sales price also provides reliable evidence of fair value.

Level 2: Inputs to the valuation methodology include quoted prices for similar assets or liabilities in active markets; inputs to the valuation methodology include quoted prices for identical or similar assets or liabilities in markets that are not active; or inputs to the valuation methodology that utilize model-based techniques for which all significant assumptions are observable in the market.

Level 3: Inputs to the valuation methodology are unobservable and significant to the fair value measurement; inputs to the valuation methodology that utilize model-based techniques for which significant assumptions are not observable in the market; or inputs to the valuation methodology that requires significant management judgment or estimation, some of which may be internally developed.

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

Assets and Liabilities Measured at Fair Value on a Recurring Basis

Investment Securities Available-for-Sale

Fair values of investment securities available-for-sale were primarily measured using information from a third-party pricing service. This pricing service provides pricing information by utilizing evaluated pricing models supported with market data information. Standard inputs include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data from market research publications. If quoted prices were available in an active market, investment securities were classified as Level 1 measurements. Level 1 investment securities included debt securities issued by the U.S. Treasury. If quoted prices in active markets were not available, fair values were estimated primarily by the use of pricing models. Level 2 investment securities were primarily comprised of mortgage-backed securities issued by government agencies and U.S. government-sponsored enterprises. In certain cases where there were limited or less transparent information provided by the Company s third-party pricing service, fair value was estimated by the use of secondary pricing services or through the use of non-binding third-party broker quotes.

On a quarterly basis, management reviews the pricing information received from the Company s third-party pricing service. This review process includes a comparison to non-binding third-party broker quotes, as well as a review of market-related conditions impacting the information provided by the Company s third-party pricing service.

Management primarily identifies investment securities which may have traded in illiquid or inactive markets by identifying instances of a significant decrease in the volume or frequency of trades, relative to historical levels, as well as instances of a significant widening of the bid-ask spread in the brokered markets. Investment securities that are deemed to have been trading in illiquid or inactive markets may require the use of significant unobservable inputs. For example, management may use quoted prices for similar investment securities in the absence of a liquid and active market for the investment securities being valued. As of June 30, 2011 and December 31, 2010, management did not make adjustments to prices provided by the third-party pricing service as a result of illiquid or inactive markets.

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Mortgage Servicing Rights

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

Other Assets

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

Derivative Financial Instruments

Derivative financial instruments recorded at fair value on a recurring basis are comprised of interest rate lock commitments, forward commitments, interest rate swap agreements, and foreign exchange contracts. The fair values of interest rate lock commitments are calculated using a discounted cash flow approach utilizing inputs such as the fall-out ratio. The fall-out ratio is derived from the Bank s internal data and is adjusted using significant management judgment as to the percentage of loans which are currently in a lock position which will ultimately not close. Interest rate lock commitments are deemed Level 3 measurements as significant unobservable inputs and management judgment are required. The fair values of forward commitments are deemed Level 2 measurements as they are primarily based on quoted prices from the secondary market based on the settlement date of the contracts, interpolated or extrapolated, if necessary, to estimate a fair value as of the end of the reporting period. The fair values of interest rate swap agreements are also calculated using a discounted cash flow approach and utilize inputs such as the London Interbank Offered Rate (LIBOR) swap curve, effective date, maturity date, notional amount, and stated interest rate. Interest rate swap agreements are deemed Level 3 measurements as significant unobservable inputs and management judgment are required. The fair values of foreign exchange contracts are calculated using the Bank s multi-currency accounting system which utilizes contract-specific information such as currency, maturity date, contractual amount, and strike price, along with market data information such as the spot rates of specific currency and yield curves. Foreign exchange contracts are deemed Level 2 measurements because while they are valued using the Bank s multi-currency accounting system, significant management judgment or estimation is not required.

The Company is exposed to credit risk if borrowers or counterparties fail to perform. The Company seeks to minimize credit risk through credit approvals, limits, monitoring procedures, and collateral requirements. The Company generally enters into transactions with borrowers and counterparties that carry high-quality credit ratings. Credit risk associated with borrowers or counterparties as well as the Company s non-performance risk is factored into the determination of the fair value of derivative financial instruments.

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The table below presents the balances of assets and liabilities measured at fair value on a recurring basis as of June 30, 2011 and December 31, 2010:

(dollars in thousands)	Quoted Prices in Active Markets for Identical Assets or Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
June 30, 2011				
Investment Securities Available-for-Sale				
Debt Securities Issued by the U.S. Treasury and Government Agencies	$ 933,539	$ 90,214	$ -	$ 1,023,753
Debt Securities Issued by States and Political Subdivisions	-	130,684	-	130,684
Debt Securities Issued by Corporations	-	43,197	-	43,197
Mortgage-Backed Securities Issued by				
Government Agencies	-	2,835,051	-	2,835,051
U.S. Government-Sponsored Enterprises	-	79,916	-	79,916
Total Mortgage-Backed Securities	-	2,914,967	-	2,914,967
Total Investment Securities Available-for-Sale	933,539	3,179,062	-	4,112,601
Mortgage Servicing Rights	-	-	8,852	8,852
Other Assets	11,863	-	-	11,863
Net Derivative Assets and Liabilities	-	327	432	759
Total Assets Measured at Fair Value on a Recurring Basis as of June 30, 2011	$ 945,402	$ 3,179,389	$ 9,284	$ 4,134,075
December 31, 2010				
Investment Securities Available-for-Sale				
Debt Securities Issued by the U.S. Treasury and Government Agencies	$ 553,894	$ 1,962	$ -	$ 555,856
Debt Securities Issued by States and Political Subdivisions	-	113,609	-	113,609
Debt Securities Issued by U.S. Government-Sponsored Enterprises	-	505	-	505
Mortgage-Backed Securities Issued by				
Government Agencies	-	5,750,028	-	5,750,028
U.S. Government-Sponsored Enterprises	-	113,876	-	113,876
Total Mortgage-Backed Securities	-	5,863,904	-	5,863,904
Total Investment Securities Available-for-Sale	553,894	5,979,980	-	6,533,874
Mortgage Servicing Rights	-	-	10,226	10,226