

GENERAL ELECTRIC CAPITAL CORP  
Form 424B3  
June 30, 2005

PROSPECTUS	Pricing Supplement No. 4206
Dated May 17, 2005	Dated June 27, 2005
PROSPECTUS SUPPLEMENT	Rule 424(b)(3)-Registration Statement
Dated May 17, 2005	No. 333-123085

GENERAL ELECTRIC CAPITAL CORPORATION

GLOBAL MEDIUM-TERM NOTES, SERIES A

(Floating Rate Notes)

Trade Date:	June 27, 2005
Settlement Date (Original Issue Date):	July 5, 2005
Maturity Date:	January 5, 2009
Principal Amount (in Specified Currency)	U.S.\$ 500,000,000
Price to Public (Issue Price):	100.00%
Agent's Discount or Commission:	0.150%
Net Proceeds to Issuer (in Specified Currency):	U.S.\$ 499,250,000

Interest Rate

:

Interest Calculation:

n Regular Floating Rate

Inverse Floating Rate

Other Floating Rate

Interest Rate Basis:	Federal Funds Open Rate (See "Additional Terms-Interest" below)
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Index Currency:	U.S. Dollars
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Spread (Plus or Minus)	Plus 0.18%
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Index Maturity:	Overnight
Spread Multiplier:	N/A
Maximum Interest Rate:	N/A
Minimum Interest Rate:	N/A
Interest Payment Period:	Quarterly
Interest Payment Dates:	Quarterly on each January 5, April 5, July 5 and October 5 of each year, commencing October 5, 2005.
Initial Interest Rate:	Determined as described herein.
Interest Reset Periods and Dates:	Daily, on each Business Day provided that the Federal Funds Open Rate in effect for any day that is not a Business Day shall be the Federal Funds Open rate in effect for the prior Business Day.
Interest Determination Dates:	On each Interest Reset Date.

CAPITALIZED TERMS USED IN THIS PRICING SUPPLEMENT WHICH ARE DEFINED IN THE PROSPECTUS SUPPLEMENT SHALL HAVE THE MEANINGS ASSIGNED TO THEM IN THE PROSPECTUS SUPPLEMENT.

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Clearance and Settlement

:

X            DTC Only.

— DTC global (including through its indirect participants Euroclear and Clearstream, Luxembourg as described under "Global Clearance and Settlement Procedures" in the accompanying Prospectus Supplement).

— DTC and Euroclear/Clearstream, Luxembourg (as described under "Description of Notes - General - *Special Provisions Relating to Certain Foreign Currency Notes*" in the accompanying Prospectus Supplement).

— Euroclear and Clearstream, Luxembourg only.

CUSIP No.: K6962GR63

Repayment, Redemption and Acceleration

Optional Repayment Date(s): N/A

Initial Redemption Date: N/A

Initial Redemption Percentage: N/A

Annual Redemption Percentage Reduction: N/A

Modified Payment Upon Acceleration: N/A

Original Issue Discount

:

Amount of OID: N/A

Yield to Maturity: N/A

Interest Accrual Date: N/A

Initial Accrual Period OID: N/A

Amortizing Notes

:

Amortization Schedule: N/A

-

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Dual Currency Notes

:

Face Amount Currency: N/A

Optional Payment Currency: N/A

Designated Exchange Rate: N/A

Option Value Calculation Agent: N/A

Option Election Date(s): N/A

Indexed Notes

:

Currency Base Rate: N/A

Determination Agent: N/A

Listing:

—

Listed on the Luxembourg Exchange

X Not listed on the Luxembourg Exchange

Additional Information

:

General.

At March 31, 2005, the Company had outstanding indebtedness totaling \$350.741 billion, consisting of notes payable within one year, senior notes payable after one year and subordinated notes payable after one year. The total amount of outstanding indebtedness at March 31, 2005, excluding subordinated notes payable after one year was equal to \$349.921 billion.

Consolidated Ratio of Earnings to Fixed Charges.

The information contained in the Prospectus under the caption "Consolidated Ratio of Earnings to Fixed Charges" is hereby amended in its entirety, as follows:

<u>Year Ended December 31</u>					<u>Three Months Ended</u>
					<u>March 31, 2005</u>
<u>2000</u>	<u>2001</u>	<u>2002</u>	<u>2003</u>	<u>2004</u>	
	(Restated)	(Restated)	(Restated)	(Restated)	
1.52	1.73	1.66	1.86	1.89	1.74

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For purposes of computing the consolidated ratio of earnings to fixed charges, earnings consist of net earnings adjusted for the provision for income taxes, minority interest and fixed charges. Fixed charges consist of interest and

discount on all indebtedness and one-third of rentals, which the Company believes is a reasonable approximation of the interest factor of such rentals.

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Additional Terms:

*Interest*

The interest rate applicable to each Interest Reset Period will equal the Federal Funds Open Rate (as defined below) plus the Spread set forth above.

The "Federal Funds Open Rate" for an Interest Determination Date will be the rate for that day under the heading "Federal Funds" for the relevant Index Maturity and opposite the caption "Open" as such rate is displayed on Moneyline Telerate Page 5.

If on a Calculation Date for an Interest Period such rate for an Interest Determination Date in that Interest Period does not appear on Moneyline Telerate Page 5, the rate for the Interest Determination Date will be the rate for that day displayed on FFPREBON Index page on Bloomberg which is the Fed Funds Opening Rate as reported by Prebon Yamane (or a successor) on Bloomberg.

If on a Calculation Date for an Interest Period such rate for an Interest Determination Date in that Interest Period does not appear on Moneyline Telerate Page 5 or FFPREBON Index page on Bloomberg, the rate for such Interest Determination Date will be the arithmetic mean of the rates for the last transaction in overnight U.S. Dollar Federal Funds prior to 9.00 am, New York City time, on that day arranged by three brokers of Federal Funds transactions in New York City as selected by the Calculation Agent.

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Plan of Distribution

:

The Notes are being purchased by Merrill Lynch, Pierce, Fenner & Smith Incorporated (the "Underwriter"), as principal, at 100.00% of the aggregate principal amount less an underwriting discount equal to 0.150% of the principal amount of the Notes.

The Company has agreed to indemnify the Underwriter against certain liabilities, including liabilities under the Securities Act of 1933, as amended.

/td>

First mortgage:

One- to four-family residential

10

75

24

3

9



Construction, commercial and other

—

—

1

11

2

Home equity loans and lines of credit

—

—

—

47

4

Other loans

6

6

12

12

15

Total recoveries

16

81

37

73

30

Net (charge-offs) recoveries

(25)

44

(24)

20

(155)

Provision for loan losses

119

52

310

455

360

Balance at end of year

\$

2,642

\$

2,548

\$

2,452

\$

2,166

\$

1,691

Ratios:

Net charge-offs to average loans outstanding

-

%

-

%

-

%

-

%

0.02

%

Allowance for loan losses to nonperforming loans at end of year



119.39

%

60.28

%

53.78

%

40.00

%

37.97

%

Allowance for loan losses to total loans at end of year

0.17

%

0.17

%

0.18

%

0.18

%

0.17

%

50

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Allocation of Allowance for Loan Losses. The following tables set forth the allowance for loan losses allocated by loan category and the percent of loans in each category to total loans at the dates indicated. The allowance for loan losses allocated to each category is not necessarily indicative of future losses in any particular category. The allowance for loan losses for each category is affected by the national and Hawaii economies as well as other factors.

	At December 31, 2018			2017			2016		
	Allowance for Loan Losses (Dollars in thousands)	Percent of Loans in Each Category to Total Loans		Allowance for Loan Losses	Percent of Loans in Each Category to Total Loans		Allowance for Loan Losses	Percent of Loans in Each Category to Total Loans	
Real estate loans:									
First mortgage:									
One- to four-family residential	\$ 1,781	96.88	%	\$ 1,706	96.65	%	\$ 1,579	96.11	%
Multi-family residential	16	0.77		15	0.72		15	0.71	
Construction, commercial and other	443	1.31		539	1.46		519	1.74	
Home equity loans and lines of credit	1	0.70		1	0.86		2	1.10	
Other loans	47	0.34		55	0.31		115	0.34	
Total allocated allowance	2,288	100.00		2,316	100.00		2,230	100.00	
Unallocated	354	—		232	—		222	—	
Total	\$ 2,642	100.00	%	\$ 2,548	100.00	%	\$ 2,452	100.00	%

	At December 31, 2015			2014		
	Allowance for Loan Losses (Dollars in thousands)	Percent of Loans in Each Category to Total Loans		Allowance for Loan Losses	Percent of Loans in Each Category to Total Loans	
Real estate loans:						
First mortgage:						
One- to four-family residential	\$ 1,365	95.90	%	\$ 410	95.08	%

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Multi-family residential	15	0.82		3	0.92	
Construction, commercial and other	517	1.62		977	1.89	
Home equity loans and lines of credit	3	1.28		5	1.64	
Other loans	72	0.38		263	0.47	
Total allocated allowance	1,972	100.00		1,658	100.00	
Unallocated	194	—		33	—	
Total	\$ 2,166	100.00	%	\$ 1,691	100.00	%

In 2015, we revised the qualitative factors that were used to determine the allowance for loan losses. As a result of these modifications, we increased the portion of the allowance for loan losses attributable to first mortgage loans and decreased the portion of the allowance for loan losses attributable to construction, commercial and other mortgage loans, and other loans. The allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories.

#### Management of Market Risk

General. Our most significant form of market risk is interest rate risk because, as a financial institution, the majority of our assets and liabilities are sensitive to changes in interest rates. Therefore, a principal part of our operations is to manage interest rate risk and limit the exposure of our net interest income to changes in market interest rates. Our Board of Directors has established an Asset/Liability Management Committee, which is responsible for evaluating the interest rate risk inherent in our assets and liabilities, for determining the level of risk that is appropriate,

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given our business strategy, operating environment, capital, liquidity and performance objectives, and for managing this risk consistent with the guidelines approved by the Board of Directors.

Because we have historically operated as a traditional thrift institution, the significant majority of our assets consist of long-term, fixed-rate residential mortgage loans and mortgage-backed securities, which we have funded primarily with checking and savings accounts and short-term borrowings. In addition, there is little demand for adjustable-rate mortgage loans in the Hawaii market area. This has resulted in our being particularly vulnerable to increases in interest rates, as our interest-bearing liabilities mature or reprice more quickly than our interest-earning assets.

We continue our efforts to reduce interest rate risk. In 2018 and 2017, we sold \$10.0 million and \$25.0 million, respectively, of fixed-rate mortgage loans. In 2018 and 2017, we obtained \$86.6 million and \$43.8 million, respectively, of long-term public deposits. In 2018 and 2017, we increased our long-term FHLB borrowings by \$5.0 million and \$20.0 million, respectively, to reduce our interest rate risk. In addition, we may utilize the following strategies to further reduce our interest rate risk:

- Continuing our efforts to increase our core checking and passbook accounts, which are less rate-sensitive than certificates of deposit and which provide us with a stable, low-cost source of funds;
- Continuing to repay short-term borrowings;
- Maintaining overnight cash balances at the Federal Reserve Bank or a portfolio of short-term investments;
- Purchasing mortgage-backed securities with shorter durations;
- Selling a portion of the fixed-rate mortgage loans we originate to Freddie Mac or Fannie Mae;
- Extending the maturity of our liabilities by obtaining longer-term fixed-rate public deposits, FHLB advances and securities sold under agreements to repurchase;
- Subject to the maintenance of our credit quality standards, originating commercial loans and home equity lines of credit, which have adjustable interest rates and shorter average lives than first mortgage loans; and
- Maintaining relatively high regulatory capital ratios.

Our policies do not permit hedging activities, such as engaging in futures, options or swap transactions, or investing in high-risk mortgage derivatives, such as collateralized mortgage obligation residual interests, real estate mortgage investment conduit residual interests or stripped mortgage-backed securities. We have no current intention to sell loans classified as held-for-investment.

**Economic Value of Equity.** We use an interest rate sensitivity analysis that computes changes in the economic value of equity (EVE) of our cash flows from assets, liabilities and off-balance sheet items in the event of a range of assumed changes in market interest rates. EVE represents the market value of portfolio equity and is equal to the present value of assets minus the present value of liabilities, with adjustments made for off-balance sheet items. This analysis assesses the risk of loss in market-risk-sensitive instruments in the event of an instantaneous and sustained 100 to 400 basis point increase or a 100 to 200 basis point decrease in market interest rates with no effect given to any steps that we might take to counter the effect of that interest rate movement. A basis point equals one-hundredth of one percent, and 100 basis points equals one percent. An increase in interest rates from 3% to 4% would mean, for example, a 100 basis point increase in the “Change in Interest Rates” column below. Given the current relatively low level of market interest rates, an EVE calculation for an interest rate decrease of greater than 200 basis points has not been prepared.

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The following table presents our internal calculations of the estimated changes in our EVE as of December 31, 2018 that would result from the designated instantaneous changes in the interest rate yield curve.

Change in Interest Rates (bp) (1)	Estimated EVE (2)	Estimated Increase (Decrease) in EVE	Percentage Change in EVE	EVE Ratio as a Percent of Present Value of Assets (3)(4)	Increase (Decrease) in EVE Ratio as a Percent of Present Value of Assets (3)(4)
(Dollars in thousands)					
+400	\$ 139,878	\$ (113,148)	(44.72)	% 8.54	% (3.92)
+300	\$ 172,800	\$ (80,226)	(31.71)	% 9.98	% (2.48)
+200	\$ 208,117	\$ (44,909)	(17.75)	% 11.35	% (1.11)
+100	\$ 239,955	\$ (13,071)	(5.17)	% 12.38	% (0.08)
0	\$ 253,026	\$ —	—	% 12.46	% —
(100)	\$ 232,940	\$ (20,086)	(7.94)	% 11.09	% (1.37)
(200)	\$ 170,816	\$ (82,210)	(32.49)	% 8.00	% (4.46)

- (1) Assumes an instantaneous uniform change in interest rates at all maturities.  
(2) EVE is the difference between the present value of an institution's assets and liabilities.  
(3) Present value of assets represents the discounted present value of incoming cash flows on interest-earning assets.  
(4) EVE Ratio represents EVE divided by the present value of assets.

Certain shortcomings are inherent in the methodologies used in determining interest rate risk through changes in EVE. Modeling changes in EVE requires making certain assumptions that may or may not reflect the manner in which actual yields and costs respond to changes in market interest rates. In this regard, the EVE table presented assumes that the composition of our interest-sensitive assets and liabilities existing at the beginning of a period remains constant over the period being measured and assumes that a particular change in interest rates is reflected uniformly across the yield curve regardless of the duration or repricing of specific assets and liabilities. Accordingly, although the EVE table provides an indication of our interest rate risk exposure at a particular point in time, such measurements are not intended to and do not provide a precise forecast of the effect of changes in market interest rates on our EVE and net interest income and will differ from actual results.

### Liquidity and Capital Resources

Liquidity is the ability to meet current and future financial obligations. Territorial Savings Bank's primary sources of funds consist of deposit inflows, cash balances at the FRB, loan and security repayments, advances from the FHLB, securities sold under agreements to repurchase, proceeds from loan and security sales and principal repayments on securities. While maturities and scheduled amortization of loans and securities are predictable sources of funds, deposit flows and mortgage prepayments are greatly influenced by general interest rates, economic conditions and competition. We have established an Asset/Liability Management Committee, consisting of our President and Chief

Executive Officer, our Vice Chairman and Co-Chief Operating Officer, our Senior Vice President and Chief Financial Officer and our Vice President and Controller, which is responsible for establishing and monitoring our liquidity targets and strategies in order to ensure that sufficient liquidity exists for meeting the borrowing needs and deposit withdrawals of our customers as well as unanticipated contingencies. We believe that we have enough sources of liquidity to satisfy our short- and long-term liquidity needs as of December 31, 2018.

We regularly monitor and adjust our investments in liquid assets based upon our assessment of:

- (i) expected loan demand;
- (ii) purchases and sales of investment securities;
- (iii) expected deposit flows and borrowing maturities;
- (iv) yields available on interest-earning deposits and securities; and
- (v) the objectives of our asset/liability management program.



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Excess liquid assets are invested generally in interest-earning deposits or securities and may also be used to pay off short-term borrowings.

Our most liquid asset is cash. The amount of this asset is dependent on our operating, financing, lending and investing activities during any given period. At December 31, 2018, the Company's cash and cash equivalents totaled \$47.1 million.

If we require funds beyond our ability to generate them internally, borrowing agreements exist with the FHLB, which provide an additional source of funds. We also utilize securities sold under agreements to repurchase as another borrowing source. At December 31, 2018, we had the ability to borrow up to an additional \$769.3 million from the FHLB. Advances from the FHLB and securities sold under agreements to repurchase were \$142.2 million and \$30.0 million, respectively for the year ended December 31, 2018. In 2018, FHLB advances increased by \$35.0 million while securities under agreements to repurchase remained constant. The increase in FHLB advances was used primarily to reduce our interest rate risk.

Our cash flows are derived from operating activities, investing activities and financing activities as reported in our Consolidated Statements of Cash Flows included in our Consolidated Financial Statements.

At December 31, 2018, we had \$7.9 million in loan commitments outstanding, most of which were for fixed-rate loans. In addition to commitments to originate loans, we had \$26.9 million in unused lines of credit to borrowers. Certificates of deposit due within one year of December 31, 2018 totaled \$206.4 million, or 12.7% of total deposits. If these deposits do not remain with us, we may be required to seek other sources of funds, including loan sales, brokered deposits, securities sold under agreements to repurchase and FHLB advances. Depending on market conditions, we may be required to pay higher rates on such deposits or other borrowings than we currently pay on the certificates of deposit due on or before December 31, 2019. We believe, however, based on past experience that a significant portion of such deposits will remain with us. We have the ability to attract and retain deposits by adjusting the interest rates offered.

Our primary investing activities are originating loans and purchasing mortgage-backed securities. During the years ended December 31, 2018 and 2017, we originated \$232.5 million and \$337.2 million of loans, respectively. During these years, we purchased \$15.0 million and \$59.9 million of securities, respectively.

Financing activities consist primarily of activity in deposit accounts, FHLB advances, securities sold under agreements to repurchase, stock repurchases and dividend payments. We experienced net increases in deposits of \$31.9 million and \$104.1 million for the years ended December 31, 2018 and 2017, respectively. Deposit flows are

affected by the overall level of interest rates, the interest rates and products offered by us and our local competitors, and by other factors.

As a separate legal entity, the Company is required to have liquidity to fund stock repurchases and dividend payments to shareholders and for other corporate purposes. As of December 31, 2018, we have 1,601,065 shares that may be purchased under our current share repurchase program. Shares repurchased will reduce the amount of shares issued and outstanding. The repurchased shares may be reissued in connection with share-based compensation plans and for general corporate purposes. During the year ended December 31, 2018, the Company repurchased 303,500 shares of common stock at an average cost of \$30.36 as part of the repurchase programs authorized by the Board of Directors. There were no shares repurchased as part of our common stock repurchase program during 2017. At December 31, 2018 and 2017, on a stand-alone basis, the Company had cash in banks of \$16.4 million and \$20.1 million, respectively.

Territorial Savings Bank and the Company are subject to various regulatory capital requirements, including a risk-based capital measure. The risk-based capital guidelines include both a definition of capital and a framework for calculating risk-weighted assets by assigning balance sheet assets and off-balance sheet items to broad risk categories. At December 31, 2018, Territorial Savings Bank and the Company exceeded all regulatory capital requirements and are considered to be “well capitalized” under regulatory guidelines. See Note 23 of the Notes to the Consolidated Financial Statements.

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## Off-Balance Sheet Arrangements and Aggregate Contractual Obligations

Commitments. As a financial services provider, we routinely are a party to various financial instruments with off-balance-sheet risks, such as commitments to extend credit and unused lines of credit. While these contractual obligations represent our potential future cash requirements, a significant portion of commitments to extend credit may expire without being drawn upon. Such commitments are subject to the same credit policies and approval process accorded to loans we make. In addition, we enter into commitments to sell mortgage loans. For additional information, see Note 22 of the Notes to the Consolidated Financial Statements.

Contractual Obligations. In the ordinary course of our operations, we enter into certain contractual obligations. Such obligations include operating leases for premises and equipment, agreements with respect to borrowed funds and deposit liabilities and agreements with respect to investments.

The following table summarizes our significant fixed and determinable contractual obligations and other funding needs by payment date at December 31, 2018. The payment amounts represent those amounts due to the recipient and do not include any unamortized premiums or discounts or other similar carrying amount adjustments.

Contractual Obligations	Payments Due by Period				Total
	One Year or Less	More Than One Year to Three Years	More Than Three Years to Five Years	More Than Five Years	
	(In thousands)				
Long-term debt	\$ 132,200	\$ 40,000	\$ —	\$ —	\$ 172,200
Operating leases	2,759	4,143	3,072	4,034	14,008
Capitalized leases	—	—	—	—	—
Purchase obligations	2,694	5,253	2,623	27	10,597
Certificates of deposit	206,375	135,835	48,931	—	391,141
Other long-term liabilities	—	—	—	—	—
Total	\$ 344,028	\$ 185,231	\$ 54,626	\$ 4,061	\$ 587,946
Commitments to extend credit	\$ 7,921	\$ —	\$ —	\$ —	\$ 7,921

## Recent Accounting Pronouncements

For a discussion of recent accounting pronouncements, see Note 2(v) with our audited financial statements.

## Impact of Inflation and Changing Prices

Our consolidated financial statements and related notes have been prepared in accordance with U.S. GAAP. U.S. GAAP generally requires the measurement of financial position and operating results in terms of historical dollars without consideration of changes in the relative purchasing power of money over time due to inflation. The impact of inflation is reflected in the increased cost of our operations. Unlike industrial companies, our assets and liabilities are primarily monetary in nature. As a result, changes in market interest rates have a greater impact on performance than the effects of inflation.

## ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

Information required by this item is included in “ITEM 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations,” above.

## ITEM 8. Financial Statements and Supplementary Data

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Report of Independent Registered Public Accounting Firm

To the Stockholders and the Board of Directors of

Territorial Bancorp, Inc.

Opinions on the Financial Statements and Internal Control over Financial Reporting

We have audited the accompanying consolidated balance sheets of Territorial Bancorp, Inc. and subsidiaries (the “Company”) as of December 31, 2018 and 2017, the related consolidated statements of income, comprehensive income, stockholders’ equity, and cash flows for the years then ended, and the related notes (collectively referred to as the “consolidated financial statements”). We also have audited the Company’s internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework 2013 issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2018 and 2017, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2018, based on criteria established in Internal Control - Integrated Framework 2013 issued by COSO.

Basis for Opinions

The Company’s management is responsible for these consolidated financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the Company’s consolidated financial statements and an opinion on the Company’s internal control over financial reporting based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (“PCAOB”) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free of

material misstatement, whether due to error or fraud, and whether effective internal control over financial reporting was maintained in all material respects.

Our audits of the consolidated financial statements included performing procedures to assess the risks of material misstatement of the consolidated financial statements, whether due to error or fraud, and performing procedures to respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the consolidated financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of

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internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

Definition and Limitations of Internal Control Over Financial Reporting

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ Moss Adams LLP

Portland, Oregon

March 15, 2019

We have served as the Company's auditor since 2015.

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## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Balance Sheets

December 31, 2018 and 2017

(Dollars in thousands, except share data)

	December 31, 2018	December 31, 2017
<b>ASSETS</b>		
Cash and cash equivalents	\$ 47,063	\$ 32,089
Investment securities available for sale, at fair value	2,560	2,851
Investment securities held to maturity, at amortized cost (fair value of \$364,922 and \$406,663 at December 31, 2018 and December 31, 2017, respectively)	371,517	404,792
Loans held for sale	309	403
Loans receivable, net	1,574,714	1,488,971
Federal Home Loan Bank stock, at cost	8,093	6,541
Federal Reserve Bank stock, at cost	3,114	3,103
Accrued interest receivable	5,274	5,142
Premises and equipment, net	4,823	5,721
Bank-owned life insurance	45,066	44,201
Income taxes receivable	—	1,571
Deferred income tax assets, net	4,136	4,609
Prepaid expenses and other assets	2,537	3,852
Total assets	\$ 2,069,206	\$ 2,003,846
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Liabilities:</b>		
Deposits	\$ 1,629,164	\$ 1,597,295
Advances from the Federal Home Loan Bank	142,200	107,200
Securities sold under agreements to repurchase	30,000	30,000
Accounts payable and accrued expenses	23,346	26,390
Income taxes payable	2,407	1,483
Advance payments by borrowers for taxes and insurance	7,010	6,624
Total liabilities	1,834,127	1,768,992
<b>Stockholders' Equity:</b>		
Preferred stock, \$0.01 par value; authorized 50,000,000 shares, no shares issued or outstanding	—	—
	97	99



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Common stock, \$0.01 par value; authorized 100,000,000 shares; issued and outstanding 9,645,955 and 9,915,058 shares at December 31, 2018 and December 31, 2017, respectively

Additional paid-in capital	65,090	73,050
Unearned ESOP shares	(4,893)	(5,383)
Retained earnings	182,594	172,782
Accumulated other comprehensive loss	(7,809)	(5,694)
Total stockholders' equity	235,079	234,854
Total liabilities and stockholders' equity	\$ 2,069,206	\$ 2,003,846

See accompanying notes to consolidated financial statements.

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## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Statements of Income

For the years ended December 31, 2018 and 2017

(Dollars in thousands, except per share data)

	2018	2017
Interest income:		
Loans	\$ 60,279	\$ 55,144
Investment securities	12,236	12,526
Other investments	786	663
Total interest income	73,301	68,333
Interest expense:		
Deposits	11,015	7,666
Advances from the Federal Home Loan Bank	2,010	1,105
Securities sold under agreements to repurchase	504	818
Total interest expense	13,529	9,589
Net interest income	59,772	58,744
Provision for loan losses	119	52
Net interest income after provision for loan losses	59,653	58,692
Noninterest income:		
Service fees on loan and deposit accounts	1,886	1,962
Income on bank-owned life insurance	865	907
Gain on sale of investment securities	45	431
Gain on sale of loans	72	199
Other	296	347
Total noninterest income	3,164	3,846
Noninterest expense:		
Salaries and employee benefits	22,159	21,482
Occupancy	6,324	5,937
Equipment	3,980	3,614
Federal deposit insurance premiums	608	605
Other general and administrative expenses	4,423	4,836
Total noninterest expense	37,494	36,474

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Income before income taxes	25,323	26,064
Income taxes	6,111	11,102
Net income	\$ 19,212	\$ 14,962
Basic earnings per share	\$ 2.07	\$ 1.61
Diluted earnings per share	\$ 2.03	\$ 1.57
Cash dividends declared per common share	\$ 1.14	\$ 1.20
Basic weighted-average shares outstanding	9,219,123	9,273,783
Diluted weighted-average shares outstanding	9,400,395	9,532,724

See accompanying notes to consolidated financial statements.

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TERRITORIAL BANCORP INC. AND SUBSIDIARIES

Consolidated Statements of Comprehensive Income  
For the years ended December 31, 2018 and 2017

(Dollars in thousands)

	2018	2017
Net income	\$ 19,212	\$ 14,962
Change in unfunded pension liability, net of tax	(938)	(373)
Change in unrealized loss on securities, net of tax	(42)	(5)
Other comprehensive loss, net of tax	(980)	(378)
Comprehensive income	\$ 18,232	\$ 14,584

See accompanying notes to consolidated financial statements.

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## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Statements of Stockholders' Equity

For the years ended December 31, 2018 and 2017

(Dollars in thousands, except share data)

	Common Shares Outstanding	Common Stock	Additional Paid-in Capital	Unearned ESOP Shares	Retained Earnings	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
Balances at December 31, 2016	9,778,974	\$ 98	\$ 71,914	\$ (5,872)	\$ 168,962	\$ (5,316)	\$ 229,786
Net income	—	—	—	—	14,962	—	14,962
Other comprehensive loss	—	—	—	—	—	(378)	(378)
Cash dividends declared (\$1.20 per share)	—	—	—	—	(11,142)	—	(11,142)
Share-based compensation	1,200	—	106	—	—	—	106
Allocation of 48,932 ESOP shares	—	—	1,040	489	—	—	1,529
Repurchase of shares of common stock	(160,003)	(2)	(5,127)	—	—	—	(5,129)
Exercise of options for common stock	294,887	3	5,117	—	—	—	5,120
Balances at December 31, 2017	9,915,058	\$ 99	\$ 73,050	\$ (5,383)	\$ 172,782	\$ (5,694)	\$ 234,854
Net income	—	—	—	—	19,212	—	19,212
Other comprehensive loss	—	—	—	—	—	(980)	(980)
Reclassification of deferred taxes	—	—	—	—	1,135	(1,135)	—
Cash dividends declared (\$1.14 per share)	—	—	—	—	(10,535)	—	(10,535)
Share-based compensation	4,401	—	341	—	—	—	341
Allocation of 48,932 ESOP shares	—	—	966	490	—	—	1,456
Repurchase of shares of common stock	(347,393)	(3)	(10,549)	—	—	—	(10,552)

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Exercise of options for common stock	73,889	1	1,282	—	—	—	1,283
Balances at December 31, 2018	9,645,955	\$ 97	\$ 65,090	\$ (4,893)	\$ 182,594	\$ (7,809)	\$ 235,079

See accompanying notes to consolidated financial statements.

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## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

For the years ended December 31, 2018 and 2017

(Dollars in thousands)

	2018	2017
Cash flows from operating activities:		
Net income	\$ 19,212	\$ 14,962
Adjustments to reconcile net income to net cash from operating activities:		
Provision for loan losses	119	52
Depreciation and amortization	1,255	1,129
Deferred income tax expense	829	3,436
Amortization of fees, discounts, and premiums, net	(469)	(478)
Origination of loans held for sale	(9,912)	(23,665)
Proceeds from sales of loans held for sale	10,078	25,063
Gain on sale of loans, net	(72)	(199)
Net gain on sale of real estate owned	(4)	—
Gain on sale of investment securities held to maturity	(45)	(431)
Net loss on disposal of premises and equipment	6	24
ESOP expense	1,456	1,529
Share-based compensation expense	341	106
Increase in accrued interest receivable	(132)	(410)
Net increase in bank-owned life insurance	(865)	(907)
Net (increase) decrease in prepaid expenses and other assets	1,315	(1,227)
Net increase (decrease) in accounts payable and accrued expenses	(4,367)	2,604
Net increase in advance payments by borrowers for taxes and insurance	386	922
Net (increase) decrease in income taxes receivable	1,571	(1,449)
Net increase (decrease) in income taxes payable	924	(133)
Net cash from operating activities	21,626	20,928
Cash flows from investing activities:		
Purchases of investment securities held to maturity	(14,983)	(56,899)
Purchases of investment securities available for sale	—	(2,970)
Principal repayments on investment securities held to maturity	43,959	52,831
Principal repayments on investment securities available for sale	224	99
Proceeds from sale of investment securities held to maturity	4,462	7,446
Loan originations, net of principal repayments on loans receivable	(85,547)	(152,631)
Purchases of Federal Home Loan Bank stock	(9,180)	(5,929)
Proceeds from redemption of Federal Home Loan Bank stock	7,628	4,333
Purchases of Federal Reserve Bank stock	(11)	(8)
Proceeds from sale of real estate owned	50	—

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Purchases of premises and equipment	(363)	(2,547)
Net cash from investing activities	(53,761)	(156,275)

(Continued)



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## TERRITORIAL BANCORP INC. AND SUBSIDIARIES

## Consolidated Statements of Cash Flows

For the years ended December 31, 2018 and 2017

(Dollars in thousands)

	2018	2017
Cash flows from financing activities:		
Net increase in deposits	\$ 31,869	\$ 104,095
Proceeds from advances from the Federal Home Loan Bank	215,700	144,525
Repayments of advances from the Federal Home Loan Bank	(180,700)	(106,325)
Repayments of securities sold under agreements to repurchase	—	(25,000)
Purchases of Fed Funds	10	10
Sales of Fed Funds	(10)	(10)
Repurchases of common stock	(9,270)	(9)
Cash dividends paid	(10,490)	(11,123)
Net cash from financing activities	47,109	106,163
Net increase (decrease) in cash and cash equivalents	14,974	(29,184)
Cash and cash equivalents at beginning of the period	32,089	61,273
Cash and cash equivalents at end of the period	\$ 47,063	\$ 32,089
Supplemental disclosure of cash flow information:		
Cash paid for:		
Interest on deposits and borrowings	\$ 13,862	\$ 9,231
Income taxes	2,787	9,319
Supplemental disclosure of noncash investing and financing activities:		
Company stock acquired through stock swap and net settlement transactions	\$ 1,282	\$ 5,120
Loans transferred to real estate owned	46	—
Dividends declared, not yet paid	45	19

See accompanying notes to consolidated financial statements.



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### (1) Organization

In 2009, Territorial Savings Bank completed a conversion from a mutual holding company to a stock holding company. As part of the conversion, Territorial Mutual Holding Company and Territorial Savings Group, Inc., the former holding companies for Territorial Savings Bank, ceased to exist as separate legal entities, and Territorial Bancorp Inc. became the holding company for Territorial Savings Bank. Upon completion of the conversion and reorganization, a special “liquidation account” was established in an amount equal to the total equity of Territorial Mutual Holding Company as of December 31, 2008. The liquidation account is to provide eligible account holders and supplemental eligible account holders who maintain their deposit accounts with Territorial Savings Bank after the conversion with a liquidation interest in the unlikely event of the complete liquidation of Territorial Savings Bank after the conversion.

In 2014, Territorial Savings Bank converted from a federal savings bank to a Hawaii state-chartered savings bank and became a member of the Federal Reserve System.

### (2) Summary of Significant Accounting Policies

#### (a) Description of Business

Territorial Bancorp Inc. (the Company), through its wholly-owned subsidiary, Territorial Savings Bank (the Bank), provides loan and deposit products and services primarily to individual customers through 29 branches located throughout Hawaii. We deal primarily in residential mortgage loans in the State of Hawaii. The Company’s earnings depend primarily on its net interest income, which is the difference between the interest income earned on interest-earning assets (loans receivable and investments) and the interest expense incurred on interest-bearing liabilities (deposit liabilities and borrowings). Deposits traditionally have been the principal source of the Bank’s funds for use in lending, meeting liquidity requirements, and making investments. The Company also derives funds from receipt of interest and principal repayments on outstanding loans receivable and investments, borrowings from the Federal Home Loan Bank (FHLB), securities sold under agreements to repurchase, and proceeds from issuance of common stock.

#### (b) Principles of Consolidation

The consolidated financial statements include the accounts and results of operations of Territorial Bancorp Inc. and Territorial Savings Bank and its wholly-owned subsidiaries, Territorial Real Estate Co., Inc. and Territorial Financial Services, Inc. Significant intercompany balances and transactions have been eliminated in consolidation.

(c) Cash and Cash Equivalents

Cash and cash equivalents includes cash and due from banks, interest-bearing deposits in other banks, federal funds sold, and short-term, highly liquid investments with original maturities of three months or less.

(d) Investment Securities

The Company classifies and accounts for its investment securities as follows: (1) held-to-maturity debt securities in which the Company has the positive intent and ability to hold to maturity are reported at amortized cost; (2) trading securities that are purchased for the purpose of selling in the near term are reported at fair value, with unrealized gains and losses included in current earnings; and (3) available-for-sale securities not classified as either held-to-maturity or trading securities are reported at fair value, with unrealized gains and losses excluded from current earnings and reported as a separate component of equity. At December 31, 2018 and 2017, the Company classified all of its investments, except \$2.6 million and \$2.9 million of securities, respectively, as held-to-maturity.

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A decline in the market value of any available-for-sale or held-to-maturity security below cost, that is deemed to be other than temporary, results in an impairment to reduce the carrying amount to fair value. To determine whether impairment is other than temporary, the Company considers the type of the investment, the cause of the decline in value and the amount and duration of the decline in value. It also considers whether it has the intent and ability not to sell and would not be required to sell for a sufficient period of time to recover the remaining amortized cost basis.

Gains or losses on the sale of investment securities are computed using the specific-identification method. The Company amortizes premiums and accretes discounts associated with investment securities using the interest method over the contractual life of the respective investment security. Such amortization and accretion is included in the interest income line item in the consolidated statements of income. Interest income is recognized when earned.

(e) Loans Receivable

This policy applies to all loan classes. Loans receivable are stated at the principal amount outstanding, less the allowance for loan losses, loan origination fees and costs, and commitment fees. Interest on loans receivable is accrued as earned. The Company has a policy of placing loans on a nonaccrual basis when 90 days or more contractually delinquent or when, in the opinion of management, collection of all or part of the principal balance appears doubtful. For nonaccrual loans, the Company records payments received as a reduction in principal. The Company, considering current information and events regarding the borrowers' ability to repay their obligations, considers a loan to be impaired when it is probable that the Company will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, if the loan is considered to be collateral dependent, based on the fair value of the collateral less estimated costs to sell. Impairment losses are written off against the allowance for loan losses. For nonaccrual impaired loans, the Company records payments received as a reduction in principal. A nonaccrual loan may be restored to an accrual basis when principal and interest payments are current and full payment of principal and interest is expected.

(f) Loans Held for Sale

Loans held for sale are stated at the lower of aggregate cost or market value. Net fees and costs of originating loans held for sale are deferred and are included in the basis for determining the gain or loss on sales of loans held for sale.

(g) Deferred Loan Origination Fees and Unearned Loan Discounts

Loan origination and commitment fees and certain direct loan origination costs are being deferred, and the net amount is recognized over the life of the related loan as an adjustment to yield. Net deferred loan fees are amortized using the interest method over the contractual term of the loan, adjusted for actual prepayments. Net unamortized fees on loans paid in full are recognized as a component of interest income.

(h) Real Estate Owned

Real estate owned is valued at the time of foreclosure at fair value, less estimated cost to sell, thereby establishing a new cost basis. The Company obtains appraisals based on recent comparable sales to assist management in estimating the fair value of real estate owned. Subsequent to acquisition, real estate owned is valued at the lower of cost or fair value, less estimated cost to sell. Declines in value are charged to expense through a direct write-down of the asset. Costs related to holding real estate are charged to expense while costs related to development and improvements are capitalized.

Gains from the sale of real estate owned, if any, are recognized when title has passed, minimum down payment requirements are met, the terms of any notes received are such as to satisfy continuing investment

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requirements, and the Company is relieved of any requirements for continued involvement with the properties. If the minimum down payment or the continuing investment is not adequate to meet the criteria specified in the Property, Plant and Equipment topic of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC), the Company will defer income recognition and account for such sales using alternative methods, such as installment, deposit, or cost recovery.

(i) Allowance for Loan Losses

The Company maintains an allowance adequate to cover management's estimate of probable loan losses as of the balance sheet date. The Company's allowance for loan losses is maintained at a level considered adequate to provide for losses that can be estimated based upon specific and general conditions. All loan losses are charged, and all recoveries are credited, to the allowance for loan losses. Additions to the allowance for loan losses are provided by charges to income based on various factors, which, in the Company's judgment, deserve current recognition in estimating probable losses. Charge-offs to the allowance are made when management determines that collectability of all or a portion of a loan is doubtful and available collateral is insufficient to repay the loan.

General allowances are established for loan losses on a portfolio basis for loans that do not meet the definition of impaired, in accordance with the Receivables topic of the FASB ASC. The portfolio is grouped into similar risk characteristics, primarily loan type and loan-to-value ratio. The Company applies an estimated loss rate to each loan group. The loss rates applied are based upon its loss experience adjusted, as appropriate, for environmental factors discussed below. This evaluation is inherently subjective, as it requires material estimates that may be susceptible to significant revisions based upon changes in economic and real estate market conditions. Actual loan losses may be significantly more than the allowance for loan losses the Company has established, which could have a material negative effect on its financial results.

Residential mortgage loans represent the largest segment of the Company's loan portfolio. Residential mortgage loans are secured by a first mortgage on residential real estate in Hawaii and consist primarily of fixed-rate mortgage loans which have been underwritten to Freddie Mac and Fannie Mae guidelines and have similar risk characteristics. The loan loss allowance is determined by first calculating the historical loss rate for this segment of the portfolio. The loss rate may be adjusted for qualitative and environmental factors. The allowance for loan loss is calculated by multiplying the adjusted loss rate by the total loans in this segment of the portfolio.

The adjustments to historical loss experience are based on an evaluation of several qualitative and environmental factors, including:

- changes in lending policies and procedures, including changes in underwriting standards and collections, charge-off and recovery practices;

- changes in international, national, and local economic trends;
- changes in the types of loans in the loan portfolio;
- changes in the experience and ability of personnel in the mortgage loan origination and loan servicing departments;
- changes in the number and amount of delinquent loans and classified assets;
- changes in the type and volume of loans being originated;
- changes in the value of underlying collateral for collateral dependent loans;
- changes in any concentration of credit; and
- external factors such as competition, legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio.



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The Company also uses historical loss rates adjusted for qualitative and environmental factors to establish loan loss allowances for the following portfolio segments:

- home equity loans and lines of credit; and
  
- consumer and other loans.

The Company has a limited loss experience for the construction, commercial and other mortgage segment of the loan portfolio. The loan loss allowance on this portfolio segment is determined using the loan loss rate of other financial institutions in the State of Hawaii. The allowance for loan loss is calculated by multiplying the loan loss rate of other financial institutions in the state by the total loans in this segment of the Company's loan portfolio.

The allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories. In addition, the unallocated allowance is established to provide for probable losses that have been incurred as of the reporting date but are not reflected in the allocated allowance.

While the Company uses the best information available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations. In addition, as an integral part of their examination process, the bank regulators will periodically review the allowance for loan losses. The bank regulators may require the Company to increase the allowance based on their analysis of information available at the time of their examination.

(j) Transfer of Financial Assets

Transfers of financial assets are accounted for as sales when control is surrendered. Control is surrendered when the assets have been isolated from the Company, the transferee obtains the right to pledge or exchange the assets without constraint, and the Company does not maintain effective control over the transferred assets. Mortgage loans sold for cash are accounted for as sales as the above criteria have been met.

Mortgage loans may also be packaged into securities that are issued and guaranteed by U.S. government-sponsored enterprises or a U.S. government agency. The Company receives 100% of the mortgage-backed securities issued. Securitizations are not accounted for as sales and no gain or loss is recognized. The mortgage-backed securities received in securitizations are valued at amortized cost and classified as held-to-maturity.

Mortgage loan transfers accounted for as sales and securitizations are without recourse, except for normal representations and warranties provided in sales transactions, and the Company may retain the related rights to service the loans. The retained servicing rights create mortgage servicing assets that are accounted for in accordance with the Transfers and Servicing topic of the FASB ASC. Mortgage servicing assets are initially valued at fair value and subsequently at the lower of cost or fair value and are amortized in proportion to and over the period of estimated net servicing income. The Company uses a discounted cash flow model to determine the fair value of retained mortgage servicing rights. Prior to 2010, we retained the servicing rights on residential mortgage loans sold. In 2010, we began selling loans primarily on a servicing-released basis.

(k) Premises and Equipment

Premises and equipment are stated at cost less accumulated depreciation and amortization. Depreciation is principally computed on the straight-line method over the estimated useful lives of the respective assets. The estimated useful life of buildings and improvements is 30 years, furniture, fixtures, and equipment is 3 to 10 years, and automobiles are 3 years. Leasehold improvements are amortized on a straight-line basis over the shorter of the lease term or estimated useful life of the asset.

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(l) Income Taxes

The Company files consolidated federal income tax and consolidated state franchise tax returns.

Deferred tax assets and liabilities are recognized using the asset and liability method of accounting for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

We establish income tax contingency reserves for potential tax liabilities related to uncertain tax positions. A liability for income tax uncertainties would be recorded for unrecognized tax benefits related to uncertain tax positions where it is more likely than not that the position will be sustained upon examination by a taxing authority.

As of December 31, 2018 and 2017, the Company had not recognized a liability for income tax uncertainties in the accompanying consolidated balance sheets because management concluded that the Company does not have uncertain tax positions.

The Company recognizes interest and penalties related to tax liabilities in other interest expense and other general and administrative expenses, respectively, in the consolidated statements of income.

Tax years 2015 to 2017 currently remain subject to examination by the Internal Revenue Service and by the Department of Taxation of the State of Hawaii.

(m) Impairment of Long-Lived Assets

Long-lived assets, such as premises and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the consolidated balance sheets and reported at the lower of

the carrying amount or fair value less costs to sell, and are no longer depreciated.

(n) Pension Plan

Pension benefit costs (returns) are charged (credited) to salaries and employee benefits expense, and the corresponding prepaid (accrued) pension cost is recorded in prepaid expenses and other assets or accounts payable and accrued expenses in the consolidated balance sheets. The Company's policy is to fund pension costs in amounts that will not be less than the minimum funding requirements of the Employee Retirement Income Security Act of 1974 and will not exceed the maximum tax-deductible amounts. The Company generally funds at least the net periodic pension cost, subject to limits and targeted funded status as determined with the consulting actuary.

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(o) Share-Based Compensation

The Company grants share-based compensation awards, including restricted stock and restricted stock units, which are either performance-based or time-based. The fair value of the restricted stock and restricted stock unit awards were based on the closing price of the Company's stock on the date of grant. The cost of these awards are amortized in the consolidated statement of income on a straight-line basis over the vesting period. The amount of performance-based restricted stock units that vest on a performance condition is remeasured quarterly based on how the Company's return on average equity compares to the SNL Bank Index. The fair value of performance-based restricted stock units that are based on how the Company's total stock return compares to the SNL Bank Index was measured using a Monte-Carlo valuation.

(p) Supplemental Employee Retirement Plan (SERP)

The SERP is a noncontributory supplemental retirement plan covering certain current and former employees of the Company. Benefits in the SERP plan are paid after retirement, in addition to the benefits provided by the Pension Plan. The Company accrues SERP costs over the estimated period until retirement by charging salaries and employee benefits expense in the consolidated statements of income, with a corresponding credit to accounts payable and accrued expenses in the consolidated balance sheets.

(q) Employee Stock Ownership Plan (ESOP)

The cost of shares issued to the ESOP, but not yet allocated to participants, is shown as a reduction of stockholders' equity. Compensation expense is based on the market price of shares as they are committed to be released to participant accounts. Dividends on allocated ESOP shares reduce retained earnings; dividends on unearned ESOP shares reduce debt and accrued interest.

(r) Earnings Per Share

Basic earnings per share is computed by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net income by the sum of the weighted-average number of shares outstanding plus the dilutive effect of stock options and restricted stock. ESOP shares not committed to be released are not considered outstanding.

We have two forms of our outstanding common stock: common stock and unvested restricted stock awards. Holders of unvested restricted stock awards receive non-forfeitable dividends at the same rate as common shareholders and they both share equally in undistributed earnings.

(s) Common Stock Repurchase Program

The Company adopted common stock repurchase programs in which shares repurchased reduce the amount of shares issued and outstanding. The repurchased shares may be reissued in connection with share-based compensation plans and for general corporate purposes. During 2018, the Company repurchased 303,500 shares of common stock at an average cost of \$30.36 as part of the repurchase programs authorized by the Board of Directors. There were no shares repurchased as part of our common stock repurchase program during 2017.

(t) Bank-Owned Life Insurance

The Company's investment in bank-owned life insurance is based on cash surrender value. The Company invests in bank-owned life insurance to provide a funding source for benefit plan obligations. Bank-owned life insurance also generally provides noninterest income that is nontaxable. Federal regulations generally limit the investment in bank-owned life insurance to 25% of the Bank's Tier 1 capital plus the allowance for loan losses. At December 31, 2018, this limit was \$57.1 million and the Company had invested \$45.1 million in bank-owned life insurance at that date.

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(u) Use of Estimates

The preparation of the consolidated financial statements requires management to make a number of estimates and assumptions relating to the reported amount of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses during the reporting period. Significant items subject to such estimates and assumptions include the allowance for loan losses; valuation of certain investment securities and determination as to whether declines in fair value below amortized cost are other than temporary; valuation allowances for deferred income tax assets; mortgage servicing assets; and assets and obligations related to employee benefit plans. Accordingly, actual results could differ from those estimates.

(v) Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) amended the Revenue Recognition topic of the FASB Accounting Standards Codification (ASC). The amendment seeks to clarify the principles for recognizing revenue as well as to develop common revenue standards for U.S. generally accepted accounting principles and International Financial Reporting Standards. The Company reviewed all revenue sources to determine if the sources are in scope for this guidance. Net interest income from financial assets and liabilities are explicitly excluded from the scope of the amendment. The Company's overall assessment of key in-scope revenue sources include service charges on deposit accounts, rental income from safe deposit boxes and commissions on insurance and annuity sales. Based on the Company's analysis of these revenue sources, including the amount of revenue, the timing of services rendered and timing of payment for these services, there is no material change in the timing of revenue recognition under the amendment. The Company adopted this amendment as of January 1, 2018, using the modified retrospective approach. Since there was no material impact on the timing of revenue recognition, no adjustment to beginning retained earnings was deemed necessary. See Note 25, Revenue Recognition, for further information.

In January 2016, the FASB amended the Financial Instruments – Overall topic of the FASB ASC. The amendment addresses several aspects of recognition, measurement, presentation and disclosure of financial instruments. Included are: (a) a requirement to measure equity investments at fair value, with changes in fair value recognized in net income, (b) a simplification of the impairment assessment of equity investments without readily determinable fair values, (c) the elimination of the requirement to disclose the methods and significant assumptions used to estimate the fair value of financial instruments measured at amortized cost on the balance sheet, and (d) a requirement to use the exit price notion when measuring the fair value of financial instruments for disclosure purposes. The Company adopted this amendment as of January 1, 2018, and there was no material effect on its consolidated financial statements.

In February 2016, the FASB amended the Leases topic of the FASB ASC. The primary effects of the amendment will be to recognize lease assets and lease liabilities on the balance sheet and to disclose certain information about leasing

arrangements. The amendment is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company has several lease agreements for branch locations and equipment that will require recognition on the consolidated balance sheets upon adoption of the amendment. The Company will adopt this amendment as of January 1, 2019 by recording a cumulative-effect adjustment to the opening balance of retained earnings as of that date. It is expected that the initial balances of the right of use asset and lease liability will be approximately \$12.7 million and \$13.2 million, respectively.

In June 2016, the FASB amended various sections of the FASB ASC related to the accounting for credit losses on financial instruments. The amendment changes the threshold for recognizing losses from a “probable” to an “expected” model. The new model is referred to as the current expected credit loss model and applies to loans, leases, held-to-maturity investments, loan commitments and financial guarantees. The amendment requires the measurement of all expected credit losses for financial assets as of the reporting date (including historical experience, current conditions and reasonable and supportable



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forecasts) and enhanced disclosures that will help financial statement users understand the estimates and judgments used in estimating credit losses and evaluating the credit quality of an organization's portfolio. The amendment is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company will apply the amendment's provisions as a cumulative-effect adjustment to retained earnings at the beginning of the first period the amendment is effective. The Company is currently evaluating the effects that the adoption of this amendment will have on its consolidated financial statements by gathering the information that is necessary to make the calculations required by the amendment. This may result in increased credit losses on financial instruments recorded in the consolidated financial statements.

In March 2017, the FASB amended the Compensation – Retirement Benefits topic of the FASB ASC. The amendment requires the service cost component of net benefit cost to be reported in the same line item as other compensation costs arising from employee services. It also requires the other components of net benefit cost to be reported in the income statement separately from the service cost component. The Company adopted this amendment as of January 1, 2018, and there was no material effect on its consolidated financial statements.

In August 2017, the FASB amended the Derivatives and Hedging topic of the FASB ASC. The primary focus of the amendment is to simplify hedge accounting and make the results of hedge transactions in the financial statements easier to understand. An ancillary result of the amendment is that an entity may transfer certain securities from the held-to-maturity classification to the available-for-sale classification. The amendment is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company does not engage in hedging activities. However, it is reviewing the amendment to determine whether its other provisions may benefit the Company's risk management strategies. The Company does not expect that this amendment, if adopted, will have a material effect on its consolidated financial statements.

In February 2018, the FASB amended the Income Statement – Reporting Comprehensive Income topic of the FASB ASC. Prior to the adoption of the amendment, deferred taxes previously included in accumulated other comprehensive income were not allowed to be adjusted for changes in tax rates. This amendment allows the reclassification of the tax effects resulting from the change in the federal corporate tax rate in the Tax Cuts and Jobs Act, which was passed in December 2017, from accumulated other comprehensive income to retained earnings. The amendment is effective for fiscal years beginning after December 15, 2018, with early adoption permitted in any period for which financial statements have not yet been issued. The Company adopted this amendment during the first quarter of 2018 with the reclassification of \$1.1 million of deferred taxes from accumulated other comprehensive income to retained earnings.

In August 2018, the FASB amended the Fair Value Measurement topic of the FASB ASC. The amendment affects disclosures only, and includes additions, deletions and modifications of the disclosures of assets and liabilities reported in the fair value hierarchy. The amendment is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Early adoption is permitted. Entities are allowed to early adopt any removed or modified disclosures while delaying adoption of any added disclosures until the effective date. The Company does not expect the adoption of this amendment to have a material effect on its consolidated financial statements.

In August 2018, the FASB amended the Compensation – Retirement Benefits topic of the FASB ASC. The amendment affects disclosures related to defined benefit pension or other post retirement plans and includes additions, deletions and clarifications of disclosures. The amendment is effective for fiscal years ending after December 15, 2020, with early adoption permitted. The Company does not expect the adoption of this amendment to have a material effect on its consolidated financial statements.

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## (3)Cash and Cash Equivalents

The table below presents the balances of cash and cash equivalents:

(Dollars in thousands)	December 31,	
	2018	2017
Cash and due from banks	\$ 9,771	\$ 9,114
Interest-earning deposits in other banks	37,292	22,975
Cash and cash equivalents	\$ 47,063	\$ 32,089

Interest-earning deposits in other banks consist primarily of deposits at the Federal Reserve Bank of San Francisco.

## (4)Investment Securities

The amortized cost and fair values of investment securities are as follows:

(Dollars in thousands)	Amortized Cost	Gross Gains	Unrealized Losses	Estimated Fair Value
December 31, 2018:				
Available-for-sale:				
U.S. government-sponsored mortgage-backed securities	\$ 2,644	\$ —	\$ (84)	\$ 2,560
Total	\$ 2,644	\$ —	\$ (84)	\$ 2,560
Held-to-maturity:				
U.S. government-sponsored mortgage-backed securities	\$ 371,442	\$ 2,056	\$ (9,279)	\$ 364,219
Trust preferred securities	75	628	—	703
Total	\$ 371,517	\$ 2,684	\$ (9,279)	\$ 364,922
December 31, 2017:				
Available-for-sale:				
U.S. government-sponsored mortgage-backed securities	\$ 2,870	\$ —	\$ (19)	\$ 2,851
Total	\$ 2,870	\$ —	\$ (19)	\$ 2,851
Held-to-maturity:				
U.S. government-sponsored mortgage-backed securities	\$ 404,365	\$ 6,056	\$ (4,603)	\$ 405,818
Trust preferred securities	427	418	—	845

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Total	\$ 404,792	\$ 6,474	\$ (4,603)	\$ 406,663
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The amortized cost and estimated fair value of investment securities by maturity date at December 31, 2018 are shown below. Incorporated in the maturity schedule are mortgage-backed and trust preferred securities, which are

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allocated using the contractual maturity as a basis. Expected maturities may differ from contractual maturities because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

(Dollars in thousands)	Amortized Cost	Estimated Fair Value
Available-for-sale:		
Due within 5 years	\$ —	\$ —
Due after 5 years through 10 years	—	—
Due after 10 years	2,644	2,560
Total	\$ 2,644	\$ 2,560
Held-to-maturity:		
Due within 5 years	\$ 4	\$ 4
Due after 5 years through 10 years	65	66
Due after 10 years	371,448	364,852
Total	\$ 371,517	\$ 364,922

Realized gains and losses and the proceeds from sales of held-to-maturity securities are shown in the table below. All sales of securities were U.S. government-sponsored mortgage-backed securities.

(Dollars in thousands)	Year Ended December 31,	
	2018	2017
Proceeds from sales	\$ 4,462	\$ 7,446
Gross gains	45	431
Gross losses	—	—

The sale of these mortgage-backed securities, for which the Company had already collected a substantial portion of the outstanding purchased principal (at least 85%), is in accordance with the Investments – Debt and Equity Securities topic of the FASB ASC and does not taint management's assertion of intent to hold remaining securities in the held-to-maturity portfolio to maturity.

Investment securities with amortized costs of \$308.8 million and \$287.2 million at December 31, 2018 and 2017, respectively, were pledged to secure deposits made by state and local governments, securities sold under agreements to repurchase and transaction clearing accounts.

Provided below is a summary of investment securities which were in an unrealized loss position at December 31, 2018 and 2017. The Company does not intend to sell held-to-maturity and available-for-sale securities until such

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time as the value recovers or the securities mature and it is not more likely than not that the Company will be required to sell the securities prior to recovery of value or the securities mature.

Description of securities (Dollars in thousands)	Less Than 12 Months		12 Months or Longer		Total Number of Securities	Unrealized	
	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses		Fair Value	Unrealized Losses
December 31, 2018:							
Available-for-sale:							
U.S.							
government-sponsored mortgage-backed securities	\$ —	\$ —	\$ 2,560	\$ (84)	1	\$ 2,560	\$ (84)
Held-to-maturity:							
U.S.							
government-sponsored mortgage-backed securities	\$ 57,154	\$ (254)	\$ 220,338	\$ (9,025)	81	\$ 277,492	\$ (9,279)
December 31, 2017:							
Available-for-sale:							
U.S.							
government-sponsored mortgage-backed securities	\$ 2,851	\$ (19)	\$ —	\$ —	1	\$ 2,851	\$ (19)
Held-to-maturity:							
U.S.							
government-sponsored mortgage-backed securities	\$ 41,163	\$ (299)	\$ 140,200	\$ (4,304)	49	\$ 181,363	\$ (4,603)

**Mortgage-Backed Securities.** The unrealized losses on the Company's investment in mortgage-backed securities were caused by increases in market interest rates subsequent to purchase. All of the mortgage-backed securities are guaranteed by Freddie Mac or Fannie Mae, which are U.S. government-sponsored enterprises, or Ginnie Mae, which is a U.S. government agency. Since the decline in market value is attributable to changes in interest rates and not credit quality, and the Company does not intend to sell these investments until maturity and it is not more likely than not that the Company will be required to sell such investments prior to recovery of its cost basis, the Company does not consider these investments to be other-than-temporarily impaired as of December 31, 2018 and 2017.

**Trust Preferred Securities.** At December 31, 2018, the Company owned one trust preferred security, PreTSL XXIII. PreTSL XXIII has an amortized cost and a remaining cost basis of \$75,000 at December 31, 2018. The trust preferred security represents an investment in a pool of debt obligations issued primarily by holding companies for Federal Deposit Insurance Corporation-insured financial institutions. This security is classified in the Company's held-to-maturity investment portfolio and is accounted for on a cost recovery method. In the cost recovery method,

any interest payments are used to reduce the remaining cost basis.

The trust preferred securities market is considered to be inactive as only seven transactions have occurred over the past 84 months in the same tranche of securities that we own and no new issuances of pooled trust preferred securities have occurred since 2007. We used a discounted cash flow model to determine whether this security is other-than-temporarily impaired. The assumptions used in preparing the discounted cash flow model include the following: estimated discount rates, estimated deferral and default rates on collateral, and estimated cash flows.

Based on the Company's review, the Company's investment in PreTSL XXIII did not incur additional impairment during the year ended December 31, 2018 and there is no accumulated other comprehensive loss related to noncredit factors.



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The table below provides a cumulative roll forward of credit losses recognized in earnings for debt securities held:

(Dollars in thousands)	Year Ended December 31,	
	2018	2017
Balance at the beginning of the year	\$ 2,403	\$ 2,403
Credit losses on debt securities for which other-than-temporary impairment was not previously recognized	—	—
Credit losses on debt securities which were sold	—	—
Balance at the end of the year	\$ 2,403	\$ 2,403

The Company's investment in PreTSL XXIII was sold in 2019.

## (5)Federal Home Loan Bank Stock

The Bank, as a member of the FHLB system, is required to obtain and hold shares of capital stock in the FHLB. At December 31, 2018 and 2017, the Bank met such requirement. At December 31, 2018 and 2017, the Bank owned \$8.1 million and \$6.5 million, respectively, of capital stock of the FHLB Des Moines.

The Company evaluated its investment in the stock of the FHLB Des Moines for impairment. Based on the Company's evaluation of the underlying investment, including the long-term nature of the investment and the liquidity position of the FHLB Des Moines, the Company did not consider its FHLB stock other-than-temporarily impaired.

## (6)Federal Reserve Bank Stock

The Bank, as a member of the Federal Reserve System, is required to hold shares of capital stock of the FRB of San Francisco equal to six percent of capital and surplus of the Bank. At December 31, 2018 and 2017, the Bank met such requirement. At December 31, 2018 and 2017, the Bank owned \$3.1 million of capital stock of the FRB of San Francisco.

The Company evaluated its investment in the stock of the FRB of San Francisco for impairment. Based on the Company's evaluation of the underlying investment, including the long-term nature of the investment and the liquidity position of the FRB of San Francisco, the Company did not consider its FRB stock other-than-temporarily impaired.



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## (7)Loans Receivable and Allowance for Loan Losses

The components of loans receivable are as follows:

(Dollars in thousands)	December 31, 2018	2017
Real estate loans:		
First mortgages:		
One- to four-family residential	\$ 1,531,149	\$ 1,444,625
Multi-family residential	12,151	10,799
Construction, commercial and other	20,780	21,787
Home equity loans and lines of credit	11,090	12,882
Total real estate loans	1,575,170	1,490,093
Other loans:		
Loans on deposit accounts	357	274
Consumer and other loans	4,939	4,340
Total other loans	5,296	4,614
Less:		
Net unearned fees and discounts	(3,110)	(3,188)
Allowance for loan losses	(2,642)	(2,548)
Total unearned fees, discounts and allowance for loan losses	(5,752)	(5,736)
Loans receivable, net	\$ 1,574,714	\$ 1,488,971

The table below presents the activity in the allowance for loan losses by portfolio segment:

(Dollars in thousands)	Residential Mortgage	Construction, Commercial and Other Mortgage Loans	Home Equity Loans and Lines of Credit	Consumer and Other	Unallocated	Totals
Year ended December 31, 2018:						
Balance, beginning of period	\$ 1,721	\$ 539	\$ 1	\$ 55	\$ 232	\$ 2,548
Provision (reversal of provision) for loan losses	78	(96)	—	15	122	119
	1,799	443	1	70	354	2,667
Charge-offs	(12)	—	—	(29)	—	(41)
Recoveries	10	—	—	6	—	16
Net charge-offs	(2)	—	—	(23)	—	(25)
Balance, end of period	\$ 1,797	\$ 443	\$ 1	\$ 47	\$ 354	\$ 2,642

Year ended December 31, 2017:

Balance, beginning of year	\$ 1,594	\$ 519	\$ 2	\$ 115	\$ 222	\$ 2,452
Provision (reversal of provision) for loan losses	63	20	(1)	(40)	10	52
	1,657	539	1	75	232	2,504
Charge-offs	(11)	—	—	(26)	—	(37)
Recoveries	75	—	—	6	—	81
Net recoveries (charge-offs)	64	—	—	(20)	—	44
Balance, end of year	\$ 1,721	\$ 539	\$ 1	\$ 55	\$ 232	\$ 2,548

The allowance for loan loss for each segment of the loan portfolio is generally determined by calculating the historical loss of each segment in a seven year look-back period and adding a qualitative adjustment for the following factors:

- changes in lending policies and procedures, including changes in underwriting standards and collections, charge-off and recovery practices;
- changes in international, national, and local economic trends;
- changes in the types of loans in the loan portfolio;
- changes in the experience and ability of personnel in the mortgage loan origination and loan servicing departments;

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- changes in the number and amount of delinquent loans and classified assets;
- changes in the type and volume of loans being originated;
- changes in the value of underlying collateral for collateral dependent loans;
- changes in any concentration of credit; and
- external factors such as competition, legal and regulatory requirements on the level of estimated credit losses in the existing loan portfolio.

The allocation of a portion of the allowance to one category of loans does not preclude its availability to absorb losses in other categories. The unallocated allowance is established for probable losses that have been incurred as of the reporting date but are not reflected in the allocated allowance.

Management considers the allowance for loan losses at December 31, 2018 to be at an appropriate level to provide for probable losses that can be reasonably estimated based on general and specific conditions at that date. While the Company uses the best information it has available to make evaluations, future adjustments to the allowance may be necessary if conditions differ substantially from the information used in making the evaluations. To the extent actual outcomes differ from the estimates, additional provisions for credit losses may be required that would reduce future earnings. In addition, as an integral part of their examination process, the bank regulators periodically review the allowance for loan losses and may require the Company to increase the allowance based on their analysis of information available at the time of their examination.

The table below presents the balance in the allowance for loan losses and the recorded investment in loans by portfolio segment and based on impairment method:

(Dollars in thousands)	Residential Mortgage	Construction, Commercial and Other Mortgage Loans	Home Equity Loans and Lines of Credit	Consumer and Other	Unallocated	Totals
December 31, 2018:						
Allowance for loan losses:						
Ending allowance balance:						
Individually evaluated for impairment	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
Collectively evaluated for impairment	1,797	443	1	47	354	2,642
Total ending allowance balance	\$ 1,797	\$ 443	\$ 1	\$ 47	\$ 354	\$ 2,642
Loans:						
Ending loan balance:						
Individually evaluated for impairment	\$ 2,962	\$ —	\$ 148	\$ —	\$ —	\$ 3,110

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Collectively evaluated for impairment	1,537,292	20,698	10,945	5,311	—	1,574,246
Total ending loan balance	\$ 1,540,254	\$ 20,698	\$ 11,093	\$ 5,311	\$ —	\$ 1,577,356

December 31, 2017:

Allowance for loan losses:

Ending allowance balance:

Individually evaluated for

impairment

\$ —	\$ —	\$ —	\$ —	\$ —	\$ —
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Collectively evaluated for

impairment

1,721	539	1	55	232	2,548
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Total ending allowance balance

\$ 1,721	\$ 539	\$ 1	\$ 55	\$ 232	\$ 2,548
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Loans:

Ending loan balance:

Individually evaluated for

impairment

\$ 4,977	\$ —	\$ 165	\$ —	\$ —	\$ 5,142
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Collectively evaluated for

impairment

1,447,326	21,701	12,722	4,628	—	1,486,377
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Total ending loan balance

\$ 1,452,303	\$ 21,701	\$ 12,887	\$ 4,628	\$ —	\$ 1,491,519
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The table below presents the balance of impaired loans individually evaluated for impairment by class of loans:

(Dollars in thousands)	Recorded Investment	Unpaid Principal Balance
December 31, 2018:		
With no related allowance recorded:		
One- to four-family residential mortgages	\$ 2,962	\$ 3,486
Home equity loans and lines of credit	148	224
Total	\$ 3,110	\$ 3,710
December 31, 2017:		
With no related allowance recorded:		
One- to four-family residential mortgages	\$ 4,977	\$ 5,897
Home equity loans and lines of credit	165	228
Total	\$ 5,142	\$ 6,125

The table below presents the average recorded investment and interest income recognized on impaired loans by class of loans:

(Dollars in thousands)	Average Recorded Investment	Interest Income Recognized
2018:		
With no related allowance recorded:		
One- to four-family residential mortgages	\$ 3,039	\$ 53
Home equity loans and lines of credit	156	—
Consumer and other	—	—
Total	\$ 3,195	\$ 53
2017:		
With no related allowance recorded:		
One- to four-family residential mortgages	\$ 5,112	\$ 58
Home equity loans and lines of credit	175	—
Consumer and other	—	—
Total	\$ 5,287	\$ 58

There were no loans individually evaluated for impairment with a related allowance for loan loss as of December 31, 2018 or 2017. Loans individually evaluated for impairment do not have an allocated allowance for loan loss because

they are written down to fair value at the time of impairment.



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The table below presents the aging of loans and accrual status by class of loans:

(Dollars in thousands)	30 - 59 Days Past Due	60 - 89 Days Past Due	90 Days or More Past Due	Total Past Due	Loans Not Past Due	Total Loans	Nonaccrual Loans	Loans 90 Days or More Past Due and Still Accruing
December 31, 2018:								
One- to four-family residential mortgages	\$ 40	\$ 292	\$ 838	\$ 1,170	\$ 1,526,949	\$ 1,528,119	\$ 2,065	\$ —
Multi-family residential mortgages	—	—	—	—	12,135	12,135	—	—
Construction, commercial and other mortgages	—	—	—	—	20,698	20,698	—	—
Home equity loans and lines of credit	—	29	41	70	11,023	11,093	148	—
Loans on deposit accounts	—	—	—	—	357	357	—	—
Consumer and other	3	4	—	7	4,947	4,954	—	—
<b>Total</b>	<b>\$ 43</b>	<b>\$ 325</b>	<b>\$ 879</b>	<b>\$ 1,247</b>	<b>\$ 1,576,109</b>	<b>\$ 1,577,356</b>	<b>\$ 2,213</b>	<b>\$ —</b>
December 31, 2017:								
One- to four-family residential mortgages	\$ —	\$ 1,207	\$ 1,589	\$ 2,796	\$ 1,438,725	\$ 1,441,521	\$ 4,062	\$ —
Multi-family residential mortgages	—	—	—	—	10,782	10,782	—	—
Construction, commercial and other mortgages	—	—	—	—	21,701	21,701	—	—
Home equity loans and lines of credit	—	—	41	41	12,846	12,887	165	—
Loans on deposit accounts	—	—	—	—	274	274	—	—
Consumer and other	4	—	—	4	4,350	4,354	—	—
<b>Total</b>	<b>\$ 4</b>	<b>\$ 1,207</b>	<b>\$ 1,630</b>	<b>\$ 2,841</b>	<b>\$ 1,488,678</b>	<b>\$ 1,491,519</b>	<b>\$ 4,227</b>	<b>\$ —</b>

The Company primarily uses the aging of loans and accrual status to monitor the credit quality of its loan portfolio. When a mortgage loan becomes seriously delinquent (90 days or more contractually past due), it displays weaknesses that may result in a loss. As a loan becomes more delinquent, the likelihood of the borrower repaying the

loan decreases and the loan becomes more collateral-dependent. A mortgage loan becomes collateral-dependent when the proceeds for repayment can be expected to come only from the sale or operation of the collateral and not from borrower repayments. Generally, appraisals are obtained after a loan becomes collateral-dependent or is four months delinquent. The carrying value of collateral-dependent loans is adjusted to the fair value of the collateral less selling costs. Any commercial real estate, commercial, construction or equity loan that has a loan balance in excess of a specified amount is also periodically reviewed to determine whether the loan exhibits any weaknesses and is performing in accordance with its contractual terms.

The Company had 11 nonaccrual loans with a book value of \$2.2 million at December 31, 2018 and 17 nonaccrual loans with a book value of \$4.2 million as of December 31, 2017. The Company collected interest on nonaccrual loans of \$93,000 and \$179,000 during 2018 and 2017, respectively, but due to regulatory requirements, the Company recorded the interest as a reduction of principal. The Company would have recognized additional interest income of \$133,000 and \$240,000 during 2018 and 2017, respectively, had the loans been accruing interest. The Company did not have any loans 90 days or more past due and still accruing interest as of December 31, 2018 or 2017.

There were no loans modified in a troubled debt restructuring during the year ended December 31, 2018 or 2017. There were no new troubled debt restructurings within the past 12 months that subsequently defaulted.

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The table below summarizes troubled debt restructurings by class of loans:

(Dollars in thousands)	Number of Loans	Accrual Status	Number of Loans	Nonaccrual Status	Total
December 31, 2018:					
One- to four-family residential mortgages	4	\$ 897	3	\$ 691	\$ 1,588
Home equity loans and lines of credit	—	—	1	78	78
Total	4	\$ 897	4	\$ 769	\$ 1,666
December 31, 2017:					
One- to four-family residential mortgages	4	\$ 915	5	\$ 1,074	\$ 1,989
Home equity loans and lines of credit	—	—	1	92	92
Total	4	\$ 915	6	\$ 1,166	\$ 2,081

There were no delinquent restructured loans at December 31, 2018. At December 31, 2017, one of the restructured loans, for \$149,000, was more than 149 days delinquent and not accruing interest. Restructurings include deferrals of interest and/or principal payments and temporary or permanent reductions in interest rates due to the financial difficulties of the borrowers. At December 31, 2018, we have no commitments to lend any additional funds to these borrowers.

The Company had no real estate owned as of December 31, 2018 or 2017. There were two one- to four-family residential mortgage loans totaling \$838,000 and one home equity loan for \$41,000 in the process of foreclosure as of December 31, 2018. There were three one- to four-family residential mortgage loans totaling \$650,000 and one home equity loan for \$41,000 in the process of foreclosure as of December 31, 2017.

Nearly all of our real estate loans are collateralized by real estate located in the State of Hawaii. Loan-to-value ratios on these real estate loans generally do not exceed 80% at the time of origination.

During the years ended December 31, 2018 and 2017, the Company sold mortgage loans held for sale with principal balances of \$10.0 million and \$25.0 million, respectively, and recognized gains of \$72,000 and \$199,000, respectively. The Company had one loan held for sale for \$309,000 at December 31, 2018 and one loan held for sale totaling \$403,000 at December 31, 2017.

The Company serviced loans for others of \$30.3 million and \$35.5 million at December 31, 2018 and 2017, respectively. Of these amounts, \$1.5 million relate to securitizations for which the Company continues to hold the related mortgage-backed securities at December 31, 2018 and 2017. The amount of contractually specified servicing

fees earned was \$88,000 and \$105,000 for 2018 and 2017, respectively. The fees are reported in service fees on loan and deposit accounts in the consolidated statements of income.

In the normal course of business, the Company has made loans to certain directors and executive officers under terms which management believes are consistent with the Company's general lending policies. Loans to directors and executive officers amounted to \$850,000 at December 31, 2018 and \$890,000 at December 31, 2017.

(8)Accrued Interest Receivable

The components of accrued interest receivable are as follows:

(Dollars in thousands)	December 31,	
	2018	2017
Loans receivable	\$ 4,302	\$ 4,090
Investment securities	960	1,045
Interest-bearing deposits	12	7
Total	\$ 5,274	\$ 5,142

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## (9)Mortgage Servicing Assets

Mortgage servicing assets are created when the Company sells mortgage loans and retains the rights to service the loans. Mortgage servicing assets are accounted for in accordance with the Transfers and Servicing topic of the FASB ASC and are initially valued at fair value and subsequently at the lower of cost or fair value. We amortize mortgage servicing assets in proportion to and over the period of estimated net servicing income. All servicing assets are grouped into categories based on the interest rate and original term of the loan sold. Mortgage servicing assets related to loan sales are recorded as a gain on sale of loans and totaled \$0 and \$3,000 for the years ended December 31, 2018 and 2017, respectively.

The table below presents the changes in our mortgage servicing assets:

(Dollars in thousands)	2018	2017
Balance at beginning of year	\$ 263	\$ 307
Additions	—	3
Impairments	—	—
Amortization	(37)	(47)
Balance at end of year	\$ 226	\$ 263

The table below presents the gross carrying values, accumulated amortization, and net carrying values of our mortgage servicing assets:

(Dollars in thousands)	December 31,	
	2018	2017
Gross carrying value	\$ 1,310	\$ 1,310
Accumulated amortization	(1,084)	(1,047)
Net carrying value	\$ 226	\$ 263

The estimated amortization expense for our mortgage servicing assets for the next five years and all years thereafter are as follows:

(Dollars in thousands)	
2019	\$ 31
2020	26

2021	23
2022	20
2023	18
Thereafter	108
Total	\$ 226

The Company uses a discounted cash flow model to determine the fair value of retained mortgage servicing assets. The discounted cash flow model is also used to assess impairment of servicing assets. Impairments are recorded as adjustments to amortization expense and included in service fees on loan and deposit accounts in the statements of income. Critical assumptions used in the discounted cash flow model include mortgage prepayment speeds, discount rates and cost of servicing.

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

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The table below presents the fair values and key assumptions used in determining the fair values of our mortgage servicing assets as of December 31, 2018 and 2017:

	2018	2017
Fair value, beginning of year (in thousands)	\$ 311	\$ 368
Fair value, end of year (in thousands)	291	311
Weighted average discount rate	10.50%	10.50%
Weighted average prepayment speed assumption (PSA prepayment speed)	156.4	173.3
Annual cost to service (per loan)	\$ 70	\$ 70

The PSA prepayment model assumes increasing prepayment rates for the first 30 months of a loan's term and constant prepayment rates thereafter.

## (10)Interest Rate Lock and Forward Loan Sale Commitments

The Company may enter into interest rate lock commitments with borrowers on loans intended to be sold. To manage interest rate risk on the lock commitments, the Company may also enter into forward loan sale commitments. The interest rate lock commitments and forward loan sale commitments are treated as derivatives and are recorded at their fair values in prepaid expenses and other assets or in accounts payable and accrued expenses. Changes in fair value are recorded in current earnings. At December 31, 2018, interest rate locks and forward loan sale commitments on loans held for sale amounted to \$280,000 and \$591,000, respectively.

The table below presents the location of assets and liabilities related to derivatives:

(Dollars in thousands)	Location on Balance Sheet	Asset Derivatives Fair Value at December 31,		Liability Derivatives Fair Value at December 31,	
		2018	2017	2018	2017
Interest rate contracts	Prepaid expenses and other assets	\$ 5	\$ 8	\$ —	\$ —
Interest rate contracts	Accounts payable and accrued expenses	—	—	5	8
Total derivatives		\$ 5	\$ 8	\$ 5	\$ 8

There were no gains or losses on derivatives for the years ended December 31, 2018 and 2017.

## (11) Premises and Equipment

Premises and equipment are as follows:

(Dollars in thousands)	December 31,	
	2018	2017
Land	\$ 585	\$ 585
Buildings and improvements	1,365	1,301
Leasehold improvements	13,938	13,915
Furniture, fixtures and equipment	5,502	5,727
Automobiles	115	115
	21,505	21,643
Less accumulated depreciation and amortization	(16,729)	(15,962)
	4,776	5,681
Construction in progress	47	40
Total	\$ 4,823	\$ 5,721

Depreciation expense was \$1.3 million and \$1.1 million for the years ended December 31, 2018 and 2017, respectively.



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## (12) Deposits

Deposit accounts by type are summarized with their respective weighted-average interest rates as follows:

(Dollars in thousands)	December 31, 2018		2017	
	Amount	Rate	Amount	Rate
Non-interest bearing	\$ 51,744	- %	\$ 49,725	- %
Savings accounts	991,310	0.50	1,040,248	0.46
Certificates of deposit	391,141	1.89	312,225	1.34
Money market	5,291	0.44	5,578	0.43
Checking and Super NOW	189,678	0.02	189,519	0.02
Total	\$ 1,629,164	0.77 %	\$ 1,597,295	0.56 %

The maturity of certificate of deposit accounts at December 31, 2018 is as follows (dollars in thousands):

Maturing in:	
2019	\$ 206,375
2020	80,093
2021	55,742
2022	33,819
2023	15,112
Total	\$ 391,141

Certificates of deposit with balances greater than or equal to \$250,000 totaled \$244.6 million and \$192.8 million at December 31, 2018 and 2017, respectively. Deposit accounts in the Bank are insured by the FDIC, generally up to a maximum of \$250,000 per account owner.

Interest expense by type of deposit is as follows:

(Dollars in thousands)	2018	2017
Savings	\$ 4,842	\$ 4,445
Certificates of deposit and money market	6,134	3,182
Checking and Super NOW	39	39

Total	\$ 11,015	\$ 7,666
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At December 31, 2018 and 2017, overdrawn deposit accounts totaled \$34,000 and \$22,000, respectively, and have been reclassified as loans in the consolidated balance sheets.

(13)Advances from the Federal Home Loan Bank

Federal Home Loan Bank advances are secured by a blanket pledge on the Bank's assets not otherwise pledged. At December 31, 2018 and 2017, our credit line with the FHLB Des Moines was equal to 45% and 35%, respectively, of the Bank's total assets and we had the capacity to borrow an additional \$769.3 million and \$579.4 million, respectively.

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Advances outstanding consisted of the following:

(Dollars in thousands)	December 31, 2018		2017			
	Amount	Weighted Average Rate		Amount	Weighted Average Rate	
Due within one year	\$ 107,200	2.39	%	\$ 46,200	1.39	%
Due over 1 year to 2 years	20,000	2.16		31,000	1.79	
Due over 2 years to 3 years	15,000	2.32		15,000	1.85	
Due over 3 years to 4 years	—	—		15,000	2.32	
Total	\$ 142,200	2.35	%	\$ 107,200	1.70	%

## (14) Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase are treated as financings and the obligations to repurchase the identical securities sold are reflected as a liability with the securities collateralizing the agreements classified as an asset. Securities sold under agreements to repurchase are summarized as follows:

(Dollars in thousands)	2018		2017			
	Repurchase Liability	Weighted Average Rate		Repurchase Liability	Weighted Average Rate	
Maturing:						
1 year or less	\$ 25,000	1.66	%	\$ —	—	%
Over 1 year to 2 years	5,000	1.65		25,000	1.66	
Over 2 years to 3 years	—	—		5,000	1.65	
Total	\$ 30,000	1.66	%	\$ 30,000	1.66	%

Below is a summary comparing the carrying value and fair value of securities pledged to secure repurchase agreements, the repurchase liability, and the amount at risk at December 31, 2018. The amount at risk is the greater of the carrying value or fair value over the repurchase liability and refers to the potential loss to the Company if the secured lender fails to return the security at the maturity date of the agreement. All the agreements to repurchase are with JP Morgan Securities and the securities pledged are mortgage-backed securities issued and guaranteed by U.S. government sponsored enterprises. The repurchase liability cannot exceed 90% of the fair value of securities pledged. In the event of a decline in the fair value of securities pledged to less than the required amount due to market conditions or principal repayments, the Company is obligated to pledge additional securities or other suitable

collateral to cure the deficiency.

(Dollars in thousands)	Carrying Value of Securities	Fair Value of Securities	Repurchase Liability	Amount at Risk	Weighted Average Months to Maturity
Maturing: Over 90 days	\$ 33,000	\$ 32,138	\$ 30,000	\$ 3,000	5

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## (15) Offsetting of Financial Liabilities

Securities sold under agreements to repurchase are subject to a right of offset in the event of default. See Note 14, Securities Sold Under Agreements to Repurchase, for additional information.

(Dollars in thousands)	Gross Amount of Recognized Liabilities	Gross Amount Offset in the Balance Sheet	Net Amount of Liabilities Presented in the Balance Sheet		Gross Amount Not Offset in the Balance Sheet	
			Balance Sheet	Financial Instruments	Cash Collateral Pledged	Net Amount
December 31, 2018:						
Securities sold under agreements to repurchase	\$ 30,000	\$ —	\$ 30,000	\$ 30,000	\$ —	\$ —
December 31, 2017:						
Securities sold under agreements to repurchase	\$ 30,000	\$ —	\$ 30,000	\$ 30,000	\$ —	\$ —

## (16) Income Taxes

Allocation of federal and state income taxes between current and deferred provisions is as follows:

(Dollars in thousands)	2018	2017
Current		
Federal	\$ 3,752	\$ 6,219
State	1,530	1,447
	5,282	7,666
Deferred		
Federal	600	3,273
State	229	163
	829	3,436
Total	\$ 6,111	\$ 11,102

The federal statutory corporate tax rates for the years ended December 31, 2018 and 2017 were 21% and 35%, respectively. A reconciliation of the tax provision based on the statutory corporate rate on pretax income and the provision for taxes as shown in the accompanying consolidated statements of income is as follows:

(Dollars in thousands)	2018	2017
Income tax expense at statutory rate	\$ 5,318	\$ 9,123
Income tax effect of:		
Other tax-exempt income	(182)	(317)
Share-based compensation	1	2
Meal and entertainment expenses	88	—
State income taxes, net of federal income tax benefits	1,246	1,104
Tax benefit from the exercise of stock options	(134)	(1,046)
Write-down of deferred income taxes (1)	—	2,054
Other	(226)	182
Total income tax expense	\$ 6,111	\$ 11,102
Effective income tax rate	24.13 %	42.59 %

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(1) Income tax expense for 2017 included a \$2.1 million write-down of deferred income tax assets that resulted when the federal corporate tax rate was lowered from 35% to 21% due to the Tax Cuts and Jobs Act..

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The components of income taxes payable (receivable) are as follows:

(Dollars in thousands)	December 31,	
	2018	2017
Current taxes payable (receivable):		
Federal	\$ 621	\$ (1,571)
State	1,786	1,483
	\$ 2,407	\$ (88)
Deferred taxes receivable:		
Federal	\$ (2,836)	\$ (3,178)
State	(1,300)	(1,431)
	\$ (4,136)	\$ (4,609)

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are presented below:

(Dollars in thousands)	December 31,	
	2018	2017
Deferred tax assets:		
Premises and equipment	\$ 1,037	\$ 966
Hawaii franchise tax	468	440
Unfunded pension liability	691	1,229
Allowance for loan losses	703	678
Impaired asset write-down	765	724
Employee benefit plans	2,601	2,580
Equity incentive plan	399	420
Unrealized losses on securities available-for-sale	32	17
Deferred compensation	480	453
Other	159	137
	7,335	7,644
Deferred tax liabilities:		
Net deferred loan fees	2,844	2,676
FHLB stock dividends	126	126
Prepaid expense	169	163
Premiums on loans sold	60	70
	3,199	3,035
Net deferred tax assets	\$ 4,136	\$ 4,609

Deferred tax assets and liabilities at December 31, 2018 and 2017 were calculated using federal corporate tax rates of 21%. The corporate tax rate was lowered to 21% due to the Tax Cuts and Jobs Act of 2017. The lower tax rate caused a \$2.1 million increase in income tax expense and write down of deferred income tax assets.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, management believes it is more likely than not the Company will realize the benefits of these deductible differences. The amount of the deferred tax assets considered realizable, however, could be reduced in the near term if estimates of future taxable income are reduced. There was no valuation allowance for deferred tax assets as of December 31, 2018 and 2017.



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## (17)Employee Benefit Plans

The Company has a noncontributory defined benefit pension plan (Pension Plan) that covers most employees with at least one year of service. The benefits are based on years of service and the employees' compensation during the service period. The Company's policy is to accrue the actuarially determined pension costs and to fund pension costs within regulatory guidelines. The Company reviews its assumptions on an annual basis and makes modifications to the assumptions based on current rates and trends when it is appropriate to do so. The effect of modifications to those assumptions is recorded in accumulated other comprehensive income (AOCI) beginning in 2006 and amortized to net periodic benefit cost over future periods using the corridor method. The Company believes that the assumptions utilized in recording its obligations under the plan are reasonable based on its experience and market conditions.

On November 4, 2008, the Board of Directors approved changes to the Company's defined benefit pension plan. Effective December 31, 2008, there are no further accruals of benefits for any participants and benefits do not increase with any additional years of service. Employees already enrolled in the Pension Plan as of December 31, 2008 will be 100% vested if they have at least five years of service. For employees with less than five years of service, vesting would occur at the employee's five-year anniversary date.

In addition, the Company sponsors a Supplemental Employee Retirement Plan (SERP), a noncontributory supplemental retirement benefit plan, which covers certain current and former employees of the Company for amounts in addition to those provided under the Pension Plan.

The following table sets forth the status of the Pension Plan and SERP at the dates indicated:

(Dollars in thousands)	Pension Plan		SERP	
	December 31,		2018	2017
	2018	2017	2018	2017
Accumulated benefit obligation at end of year	\$ 18,713	\$ 19,314	\$ 9,473	\$ 9,242
Change in projected benefit obligation:				
Benefit obligation at beginning of year	\$ 19,314	\$ 17,496	\$ 9,242	\$ 9,044
Service cost	141	193	97	75
Interest cost	728	763	151	140
Actuarial loss (gain)	(611)	1,670	—	—
Benefits paid	(859)	(808)	(17)	(17)
Benefit obligation at end of year	18,713	19,314	9,473	9,242
Change in plan assets:				
Fair value of plan assets at beginning of year	15,927	14,804	—	—
Actual return on plan assets	(968)	1,931	—	—
Employer contributions	3,400	—	17	17

Benefits paid