BankGuam Holding Co
Form 10-Q
November 08, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2013

or

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

For the transition period from ______ to ______.

Commission file number: 000-54483

BankGuam Holding Company

(Exact name of registrant as specified in its charter)

Guam	**66-0770448**
(State or other jurisdiction of	**(IRS Employer**
incorporation or organization)	**Identification No.)**

111 West Chalan Santo Papa

Hagatna, Guam 96910

(671) 472-5300

(Address, including Zip Code, and telephone number, including area code, of the registrant s principal executive offices)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registration was required to submit and post such files). Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨	Smaller reporting company x

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

As of September 30, 2013, the registrant had outstanding 8,792,634 shares of common stock.

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BANKGUAM HOLDING COMPANY

FORM 10-Q

QUARTERLY REPORT

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Exhibit 31.01 Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley At of 2002

Exhibit 31.02 Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.01 Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 101.INS XBRL Instance Document.

Exhibit 101.SCH XBRL Taxonomy Extension Schema Document.

Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document.

Exhibit 101.DEF XBRL Taxonomy Extension Definition Linkbase Document

Exhibit 101.LAB XBRL Taxonomy Extension Labels Linkbase Document

Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document.

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Cautionary Note Regarding Forward-Looking Statements

For purposes of this Quarterly Report, the terms the Company, we, us and our refer to BankGuam Holding Compan and its subsidiaries. This Quarterly Report on Form 10-Q contains statements that are not historical in nature, are predictive in nature, or that depend upon or refer to future events or conditions or contain forward-looking statements within the meaning of Section 21 of the Securities Exchange Act of 1934, as amended, and the Private Securities Litigation Reform Act of 1995. These include, among other things, statements regarding:

Competition for loans and deposits and failure to attract or retain deposits and loans;

Local, regional, national and global economic conditions and events, and the impact they may have on us and our customers, and our assessment of that impact on our estimates, including the allowance for loan losses;

Risks associated with concentrations in real estate related loans;

Changes in the level of nonperforming assets and charge-offs and other credit quality measures, and their impact on the adequacy of our allowance for loan losses and our provision for loan losses;

The effects of and changes in trade, monetary and fiscal policies and laws, including the interest rate policies of the Federal Open Market Committee of the Federal Reserve Board;

Stability of funding sources and continued availability of borrowings;

The effect of changes in laws and regulations with which the Company and Bank of Guam must comply, including any increase in Federal Deposit Insurance Corporation insurance premiums;

Our ability to raise capital or incur debt on reasonable terms;

Regulatory limits on Bank of Guam s ability to pay dividends to the Company;

The impact of the Dodd Frank Wall Street Reform and Consumer Protection Act and its implementing regulations;

The effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and

other accounting standard setting bodies;

Changes in the deferred tax asset valuation allowance in future quarters;

The costs and effects of legal and regulatory developments, including resolution of legal proceedings or regulatory or other governmental inquiries, and the results of regulatory examinations or reviews;

The ability to increase market share and control expenses; and,

Our success in managing the risks involved in the foregoing items,

as well as other statements regarding our future operations, financial condition and prospects, and business strategies. Forward-looking statements may be preceded by, followed by or include the words expects, anticipates, intends, plans, believes, seeks, estimates, will, is designed to and similar expressions. We claim the protection of the s harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 for all forward-looking statements. We have based these forward-looking statements on our current expectations and projections about future events. These forward-looking statements are subject to risks, uncertainties and assumptions about our business and the environment in which it operates that could affect our future results and could cause those results or other outcomes to differ materially from those expressed or implied in the forward-looking statements. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in Risk Factors included elsewhere in this Quarterly Report and as may be updated in filings we make from time to time with the U.S. Securities and Exchange Commission (SEC), including our Annual Report on Form 10-K for our fiscal year ended December 31, 2012, and our other Quarterly Reports on Form 10-Q filed by us in fiscal 2013. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or risks, except to the extent required by applicable securities laws. If we do update one or more forward-looking statements, no inference should be drawn that we will make additional updates with respect to those or other forward-looking statements. New information, future events or risks could cause the forward-looking events we discuss in this Quarterly Report not to occur. You should not place undue reliance on these forward-looking statements, which reflect our opinions only as of the date of this Quarterly Report.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements (Unaudited)

The financial statements and the notes thereto begin on the next page.

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BankGuam Holding Company

Unaudited Condensed Consolidated Statements of Condition

(in Thousands, Except Par Value)

	September 30, 2013	December 31, 2012
ASSETS		
Cash and due from banks	$ 21,960	$ 36,575
Federal Funds sold	5,000	5,000
Interest bearing deposits in banks	221,877	32,614
Total cash and cash equivalents	248,837	74,189
Restricted cash	400	150
Investment securities available for sale, at fair value	172,834	273,522
Investment securities held to maturity, at amortized cost	91,460	58,125
Federal Home Loan Bank stock, at cost	2,101	2,159
Loans, net of allowance for loan losses (9/30/13: $11,995 and 12/31/12: $12,228)	845,612	748,832
Accrued interest receivable	4,318	3,599
Premises and equipment, net	17,381	17,712
Goodwill	783	783
Other assets	31,564	32,310
Total assets	$ 1,415,290	$ 1,211,381
LIABILITIES AND STOCKHOLDERS EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$ 308,359	$ 279,322
Interest bearing	1,005,964	823,218
Total deposits	1,314,323	1,102,540
Accrued interest payable	165	161
Borrowings	0	10,145
Other liabilities	7,805	4,111
Total liabilities	1,322,293	1,116,957
Commitments and contingencies (Note 6)		
Stockholders equity:		
Common stock $0.2083 par value; 48,000 shares authorized; 8,825 and 8,814 shares issued and 8,793 and 8,782 shares outstanding at 9/30/13 and 12/31/12, respectively	1,846	1,844
Additional paid-in capital	15,390	15,304
Retained earnings	80,070	76,092

Accumulated other comprehensive (loss) income		(4,019)		1,474
		93,287		94,714
Common stock in treasury, at cost (32 shares)		(290)		(290)
Total stockholders equity		92,997		94,424
Total liabilities and stockholders equity	$	1,415,290	$	1,211,381

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

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BankGuam Holding Company

Unaudited Condensed Consolidated Statements of Income

(Dollar and Share Amounts in Thousands, Except Per Share Data)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Interest income:				
Loans	$ 15,080	$ 14,074	$ 43,452	$ 42,544
Investment securities	1,179	1,466	3,817	4,132
Federal Funds sold	2	1	5	5
Deposits with banks	51	78	181	245
Total interest income	16,312	15,619	47,455	46,926
Interest expense:				
Time deposits	68	68	195	200
Savings deposits	1,054	1,239	3,377	3,606
Other borrowed funds	0	100	81	298
Total interest expense	1,122	1,407	3,653	4,104
Net interest income	15,190	14,212	43,802	42,822
Provision for loan losses	900	975	1,195	2,925
Net interest income, after provision for loan losses	14,290	13,237	42,607	39,897
Non-interest income:				
Service charges and fees	1,109	985	3,354	3,033
Investment securities gains, net	56	243	506	423
Income from merchant services	457	413	1,424	1,506
Income from cardholders	147	191	832	977
Wire transfer fees	167	167	503	499
Trustee fees	165	196	429	533
Other income	473	515	1,540	1,591
Total non-interest income	2,574	2,710	8,588	8,562
Non-interest expenses:				
Salaries and employee benefits	6,672	6,233	19,069	18,336
Occupancy	1,785	1,567	5,158	4,654
Furniture and equipment	1,489	1,751	4,510	4,552
Insurance	420	442	1,258	1,313
Telecommunications	362	403	1,099	1,153
Federal Deposit Insurance Corporation assessment	283	266	834	751

Contract services	288	216	998	1,063
Stationery & supplies	202	202	584	682
Professional services	379	492	1,047	1,084
Education	139	151	554	377
General, administrative and other	1,503	1,543	5,747	5,181
Total non-interest expenses	13,522	13,266	40,858	39,146
Income before income taxes	3,342	2,681	10,337	9,313
Income tax expense	1,007	710	3,063	2,553
Net income	$ 2,335	$ 1,971	$ 7,274	$ 6,760
Earnings per share:				
Basic	$ 0.27	$ 0.22	$ 0.83	$ 0.77
Diluted	$ 0.27	$ 0.22	$ 0.83	$ 0.77
Dividends declared per share	$ 0.125	$ 0.125	$ 0.375	$ 0.375
Basic weighted average shares	8,793	8,779	8,788	8,779
Diluted weighted average shares	8,798	8,780	8,793	8,780

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

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BankGuam Holding Company

Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss)

(in Thousands)

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net income	$ 2,335	$ 1,971	$ 7,274	$ 6,760
Other comprehensive income (loss) components, net of tax effects:				
Unrealized holding gain (loss) on available-for-sale securities arising during the period	(1,592)	867	(5,103)	2,011
Reclassification for gains (losses) realized on available-for-sale securities	(56)	243	(506)	423
Net change in unrealized holding loss on held-to-maturity securities during the period	50	36	116	125
	(1,598)	1,146	(5,493)	2,559
Comprehensive income (loss)	$ 737	$ 3,117	$ 1,781	$ 9,319

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

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BankGuam Holding Company

Unaudited Condensed Consolidated Statements of Cash Flows

(in Thousands)

	Nine months ended September 30, 2013	2012
Cash flows from operating activities:		
Net income:	$ 7,274	$ 6,760
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	1,195	2,925
Depreciation and amortization	2,301	2,265
Amortization of fees, discounts and premiums	1,715	1,839
Write-down and (gain)/loss on sales of other real estate owned, net	88	(74)
Proceeds from sales of loans held for sale	25,599	22,537
Origination of loans held for sale	(25,599)	(22,537)
(Increase) decrease in mortgage servicing rights	(65)	(226)
Realized gain on sale of available-for-sale securities	(506)	(423)
Loss on disposal of premises and equipment	69	17
Net change in:		
Accrued interest receivable	(719)	89
Other assets	(1,389)	4,278
Accrued interest payable	4	15
Other liabilities	3,695	1,822
Net cash provided by operating activities	13,662	19,287
Cash flows from investing activities:		
Change in restricted cash	(250)	0
Purchases of available-for-sale securities	(102,777)	(175,786)
Purchases of held-to-maturity securities	0	(25,709)
Proceeds from sales of available-for-sale securities	121,527	64,674
Maturities, prepayments and calls of available-for-sale securities	29,732	29,573
Maturities, prepayments and calls of held-to-maturity securities	12,170	10,036
Loan originations and principal collections, net	(96,483)	(5,116)
Proceeds from sales of other real estate owned	620	670
Purchases of premises and equipment	(2,041)	(2,119)
Net cash used in investing activities	(37,502)	(103,777)
Cash flows from financing activities:		
Net increase in deposits	211,783	113,482
Payment of Federal Home Loan Bank advances	(10,000)	0
Proceeds from Federal Home Loan Bank stock redemption	58	20

Proceeds from related party borrowings	(145)	160
Repayment of other borrowings	0	(215)
Proceeds from issuance of common stock	88	1
Dividends paid	(3,296)	(3,292)
Net cash provided by financing activities	198,488	110,156
Net change in cash and cash equivalents:	174,648	25,666
Cash and cash equivalents at beginning of year	74,189	130,959
Cash and cash equivalents at end of year	$ 248,837	$ 156,625
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 3,653	$ 4,104
Income taxes	$ 204	$ 280
Supplemental schedule of noncash investing and financing activities:		
Net change in unrealized loss on held-to-maturity securities, net of tax	$ (3,091)	$ 125
Net change in unrealized loss on available-for-sale securities, net of tax	$ (2,402)	$ 2,434
Other real estate owned transferred from loans, net	$ 1,761	$ 519
Other real estate owned transferred to loans, net	$ (268)	$ (174)
Transfer of securities from available-for-sale	$ 49,021	$ 0
Transfer of securities to held-to-maturity	$ (49,021)	$ 0

The accompanying notes are an integral part of the condensed consolidated interim financial statements.

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BankGuam Holding Company

Notes to Condensed Consolidated Financial Statements

(In thousands, except per share data)

(Unaudited)

Note 1 Nature of Business

Organization

The accompanying condensed consolidated financial statements include the accounts of BankGuam Holding Company (Company) and its wholly-owned subsidiary, Bank of Guam (Bank). The Company is a Guam corporation organized on October 29, 2010, to act as a holding company of the Bank, a Guam banking corporation, a 23-branch bank serving the communities in Guam, the Commonwealth of the Northern Mariana Islands (CNMI), the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), the Republic of Palau (ROP), and San Francisco, California. On August 15, 2011, the Company acquired all of the outstanding common stock of the Bank in a holding company formation transaction.

Other than holding the shares of the Bank, the Company conducts no significant activities, although it is authorized, with the prior approval of its principal regulator, the Board of Governors of the Federal Reserve System (the Federal Reserve Board), to engage in a variety of activities related to the business of banking. Currently, substantially all of the Company s operations are conducted and substantially all of the assets are owned by the Bank, which accounts for substantially all of our consolidated revenues, expenses and operating income. The Bank provides a variety of financial services to individuals, businesses and governments through its branches. The Bank s headquarters is located in Hagåtña, Guam. The Bank currently has twelve branches in Guam, five in the CNMI, four in the FSM, one in the RMI, one in the ROP, and one in San Francisco, California. Its primary deposit products, which are insured by the Federal Deposit Insurance Corporation up to the maximum amounts allowed by law, are demand deposits, savings and time certificate accounts, and its primary lending products are consumer, commercial and real estate loans.

For ease of reference we will sometimes refer to the Company as we , us or our .

Note 2 Summary of Significant Accounting Policies and Recent Accounting Pronouncements

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and, therefore, do not include all footnotes that would be required for a full presentation of financial position, results of operations, changes in cash flows and comprehensive income in accordance with generally accepted accounting principles in the United States (GAAP). However, these interim financial statements reflect all adjustments (consisting of normal recurring adjustments and accruals) which, in the opinion of our management, are necessary for a fair presentation of our financial position and our results of operations for the interim periods presented.

These unaudited condensed consolidated financial statements have been prepared on a basis consistent with prior periods, and should be read in conjunction with our audited consolidated financial statements as of and for the year ended December 31, 2012, and the notes thereto, included in our Annual Report on Form 10-K for the year ended December 31, 2012, as filed with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934 on March 21, 2013.

Our consolidated financial position at September 30, 2013, and the consolidated results of operations for the three and nine month periods ended September 30, 2013, are not necessarily indicative of what our financial position will be as of December 31, 2013, or of the results of our operations that may be expected for the full year ending December 31, 2013.

The Company has evaluated events subsequent to September 30, 2013, through the date at which these unaudited consolidated financial statements are being filed with the Securities and Exchange Commission, for transactions and other events which may require adjustment of and/or disclosure in such financial statements.

Use of Estimates

The preparation of condensed consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of income and expenses during the periods presented. Actual results could differ from those estimates. Material estimates that are particularly susceptible to significant change in the near term relate to the determination of the allowance for loan losses, valuation of other real estate owned, the determination of other than temporary impairment of securities and the fair value of financial instruments.

Recent Accounting Pronouncements

On February 5, 2013, the FASB issued ASU No. 2013-02, *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which gives additional guidance to improve the reporting of reclassifications out of accumulated other comprehensive income (AOCI). For significant items reclassified out of AOCI to net income in their entirety during a reporting period, companies must report the effect on the line items in the statement where net income is presented. This can be done on the face of the statement in certain circumstances or in the notes. For public companies, this guidance is effective on a prospective basis for fiscal years and interim periods within those years beginning after December 15, 2012. The adoption of this guidance did not have a material impact on our financial statements.

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Note 3 Earnings Per Common Share

Basic earnings per share represent income available to common stockholders divided by the weighted-average number of common shares outstanding during the period. Diluted earnings per share reflect additional common shares that would have been outstanding if dilutive potential common shares had been issued, as well as any adjustment to income that would result from the assumed issuance. Potential common shares that may be issued by the Company relate to shares subscribed but not yet issued in 2013 under the Employee Stock Purchase Plan, and are reported as dilutive options.

Earnings per common share have been computed based on reported net income and the following share data:

	For the Three Months Ended September 30,		For the Nine months Ended September 30,	
	2013	2012	2013	2012
Net income available for common stockholders	$ 2,335	$ 1,971	$ 7,274	$ 6,760
Weighted average number of common shares outstanding	8,793	8,779	8,788	8,779
Effect of dilutive options	5	1	5	1
Weighted average number of common shares outstanding used to calculate diluted earnings per common share	8,798	8,780	8,793	8,780
Income per common share:				
Basic	$ 0.27	$ 0.22	$ 0.83	$ 0.77
Diluted	$ 0.27	$ 0.22	$ 0.83	$ 0.77

Under the 2011 Employee Stock Purchase Plan, eligible employees can purchase, through payroll deductions, shares of common stock at a discount. The right to purchase stocks is granted to eligible employees during a period of time that is established from time to time by the Board of Directors of the Company. Eligible employees cannot accrue the right to purchase more than $25 thousand worth of stock at the fair market value at the beginning of each offer period. Eligible employees also may not purchase more than one thousand five hundred (1,500) shares of stock in any one offer period. The shares are purchased at 85% of the fair market price of the stock on the enrollment date.

An amended Plan was approved by the Board of Directors and went into effect on September 1, 2012.

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Note 4 Investment Securities

The amortized cost and fair value of investment securities, with gross unrealized gains and losses, follows:

	September 30, 2013			
	Amortized Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Securities Available for Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 8,420	$ 0	$ 52	$ 8,472
U.S. government agency pool securities	56,270	(480)	130	55,920
U.S. government agency or GSE mortgage-backed securities	109,128	(1,126)	440	108,442
	$ 173,818	$ (1,606)	$ 622	$ 172,834
Securities Held to Maturity				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 32,687	$ 0	$ 437	$ 33,124
U.S. government agency pool securities	1,800	(9)	37	1,828
U.S. government agency or GSE mortgage-backed securities	56,973	(350)	1,153	57,776
	$ 91,460	$ (359)	$ 1,627	$ 92,728

	December 31, 2012			
	Amortized Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Securities Available for Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 59,923	$ (138)	$ 360	$ 60,145
U.S. government agency pool securities	73,663	(140)	275	73,798
U.S. government agency or GSE mortgage-backed securities	137,282	(152)	2,449	139,579
	$ 270,868	$ (430)	$ 3,084	$ 273,522
Securities Held to Maturity				
U.S. government agency pool securities	$ 1,966	$ (3)	$ 45	$ 2,008
U.S. government agency or GSE mortgage-backed securities	56,159	0	2,054	58,213
	$ 58,125	$ (3)	$ 2,099	$ 60,221

At September 30, 2013, and December 31, 2012, investment securities with a carrying value of $199.6 million and $142.3 million, respectively, were pledged to secure various government deposits and other public requirements.

The amortized cost and fair value of investment securities by contractual maturity at September 30, 2013, and December 31, 2012, are shown below. Securities not due at a single maturity date, such as agency pool securities and mortgage-backed securities, are shown separately.

	September 30, 2013			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due after one but within five years	$ 0	$ 0	$ 0	$ 0
Due after five years	8,420	8,472	32,687	33,124
U.S. Government agency pool securities	56,270	55,920	1,800	1,828
Mortgage-backed securities	109,128	108,442	56,973	57,776
Total	$ 173,818	$ 172,834	$ 91,460	$ 92,728

	December 31, 2012			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due after one but within five years	$ 4,997	$ 5,035	$ 0	$ 0
Due after five years	54,926	55,110	0	0
U.S. Government agency pool securities	73,663	73,798	1,966	2,008
Mortgage-backed securities	137,282	139,579	56,159	58,213
Total	$ 270,868	$ 273,522	$ 58,125	$ 60,221

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Temporarily Impaired Securities

The following table shows the gross unrealized losses and fair value of the Company s investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at September 30, 2013, and December 31, 2012.

	September 30, 2013					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
Securities Available for Sale						
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
U.S. government agency pool securities	(480)	48,128	0	0	(480)	48,128
U.S. government agency or GSE mortgage-backed securities	(1,126)	70,369	0	0	(1,126)	70,369
Total	$ (1,606)	$ 118,497	$ 0	$ 0	$ (1,606)	$ 118,497
Securities Held to Maturity						
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
U.S. government agency pool securities	$ (4)	$ 143	$ (5)	$ 288	$ (9)	$ 431
U.S. government agency or GSE mortgage-backed securities	(350)	19,544	0	0	(350)	19,544
Total	$ (354)	$ 19,687	$ (5)	$ 288	$ (359)	$ 19,975

	December 31, 2012					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
Securities Available for Sale						
U.S. government agency and sponsored enterprise (GSE) debt securities	$ (138)	$ 29,836	$ 0	$ 0	$ (138)	$ 29,836
U.S. government agency pool securities	(139)	29,921	(1)	76	(140)	29,997
U.S. government agency or GSE mortgage-backed securities	(136)	25,420	(16)	3,216	(152)	28,636
	$ (413)	$ 85,177	$ (17)	$ 3,292	$ (430)	$ 88,469
Securities Held to Maturity						
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0

U.S. government agency pool securities	$	0	$	29	$	(3)	$	302	$	(3)	$	331
U.S. government agency or GSE mortgage-backed securities		0		0		0		0		0		0
	$	0	$	29	$	(3)	$	302	$	(3)	$	331

The Bank does not believe that any of the investment securities that were in an unrealized loss position as of September 30, 2013, which comprised a total of 38 securities, were other-than-temporarily impaired. Specifically, the 38 securities are comprised of the following: 15 Small Business Administration (SBA) Pool securities, 3 mortgage-backed securities issued by the Federal Home Loan Mortgage Corporation (FHLMC), 15 mortgage-backed securities issued by the Government National Mortgage Association (GNMA), and 5 mortgage-backed securities issued by the Federal National Mortgage Association (FNMA).

Total gross unrealized losses were primarily attributable to changes in market interest rates, relative to when the investment securities were purchased, and not due to any change in the credit quality of the investment securities. The Company does not intend to sell the investment securities that were in an unrealized loss position and it is not likely that the Company will be required to sell the investment securities before recovery of their amortized cost bases, which may be at maturity.

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Note 5 Loans Held for Sale, Loans and Allowance for Loan Losses

Loans Held for Sale

In its normal course of business, the Bank originates mortgage loans held for sale for the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac). The Bank has elected to measure its residential mortgage loans held for sale at the lower of cost or market. Origination fees and costs are recognized in earnings at the time of origination for newly originated loans held for sale, and the loans are sold to Freddie Mac at par, so there is no gain or loss reported in earnings.

During the nine months ended September 30, 2013, the Bank has originated approximately $25.6 million and sold approximately $25.6 million.

Loans

Outstanding loan balances are presented net of unearned income, deferred loan fees, and unamortized discount and premium. Loans subject to ASC 310-30 are presented net of the related accretable yield and nonaccretable difference.

The loan portfolio consisted of the following at:

	September 30, 2013		December 31, 2012	
	Amount	Percent	Amount	Percent
	(Dollars in thousands)			
Commercial				
Commercial & industrial	$ 180,554	21.00%	$ 138,951	18.21%
Commercial mortgage	376,606	43.80%	314,462	41.22%
Commercial construction	758	0.09%	3,908	0.51%
Total commercial	557,918	64.89%	457,321	59.94%
Consumer				
Residential mortgage	157,187	18.28%	164,774	21.60%
Home equity	1,113	0.13%	1,211	0.16%
Automobile	7,556	0.88%	8,227	1.08%
Other consumer loans [1]	136,072	15.82%	131,412	17.22%
Total consumer	301,928	35.11%	305,624	40.06%
Gross loans	859,846	100.0%	762,945	100.0%
Deferred fee (income) costs, net	(2,239)		(1,885)	
Allowance for loan losses	(11,995)		(12,228)	
Loans, net	$ 845,612		$ 748,832	

[1] Comprised of other revolving credit, installment loans, and overdrafts.

At September 30, 2013, total gross loans increased by $96.9 million to $859.8 million from $762.9 million at December 31, 2012. The increase in loans is largely attributed to a $100.6 million increase in commercial loans to $557.9 million at September 30, 2013, from $457.3 million at December 31, 2012. This was due to several large loans originated in California and in Guam. The increase in commercial loans was due to a $62.1 million growth in the commercial mortgage portfolio, supplemented by the $41.6 million increase in commercial & industrial loans, and partially offset by a $3.1 million decrease in commercial construction loans. There was a $3.7 million decrease in consumer loans to $301.9 million at September 30, 2013, down from $305.6 million at December 31, 2012. The decrease in consumer loans was principally due to a $7.6 million reduction in residential mortgage loans as the result of principal paydowns, payoffs, and refinancings with the Federal Home Loan Mortgage Corporation in reaction to favorable interest rates, which was supplemented by a reduction of $671 thousand in automobile loans and partially offset by a $4.7 million increase in other consumer loans.

Allowance for Loan Losses

The allowance for loan losses is evaluated on a quarterly basis by Bank management, and is based upon management s periodic review of the collectability of loans in light of historical experience, the nature and volume of the loan portfolio, adverse situations that may affect the borrower s ability to repay, estimated value of any underlying collateral, and prevailing economic conditions. This evaluation is inherently subjective, as it requires estimates that are susceptible to significant revision as more information becomes available or conditions change.

The allowance consists of allocated and general components. The allocated component relates to loans that are classified as impaired. ASC 310-10 defines an impaired loan as one for which there is uncertainty concerning collection of all principal and interest per the contractual terms of the loan. For those loans that are classified as impaired, an allowance is established when the discounted cash flow (or the collateral value or the observable market price) of the impaired loan is lower than the carrying value of the loan. The general component covers unimpaired loans, and is estimated using a loss migration analysis based on historical charge-off experience and expected loss, given the default probability derived from the Bank s internal risk rating process. The loss migration analysis tracks a certain number of quarters of loan loss history and industry loss factors to determine historical losses by classification category for each loan type, except certain consumer loans. These calculated loss factors are then applied to outstanding loan balances for all loans on accrual designated as Pass, Special Mention, Substandard or Doubtful (classified loans or

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classification categories). Additionally, a qualitative factor that is determined utilizing external economic factors and internal assessments is applied to each homogeneous loan pool. We also conduct individual loan review analyses, as part of the allowance for loan loss allocation process, applying specific monitoring policies and procedures in analyzing the existing loan portfolio.

Credit Quality Indicators

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

The following are the definitions of the Bank s credit quality indicators:

Pass (A): *Exceptional:* Essentially risk-free credit. These are loans of the highest quality that pose virtually no risk of loss to the Bank. This includes loans fully collateralized by means of a savings account(s) and time certificate(s) of deposit, and by at least 110% of the loan amount. Borrowers should have strong financial statements, good liquidity and excellent credit.

Pass (B): *Standard:* Multiple strong sources of repayment . These are loans to strong borrowers with a demonstrated history of financial and managerial performance. The risk of loss is considered to be low. Loans are well-structured, with clearly identified primary and readily available secondary sources of repayment. These loans may also be secured by an equal amount of funds in a savings account or time certificate of deposit. These loans may be secured by marketable collateral whose value can be reasonably determined through outside appraisals. The borrower characteristically has a very strong cash flow and relatively low leverage.

Pass (C): *Acceptable:* Good primary and secondary sources of repayment. These are loans to borrowers of average financial strength, stability and management expertise. The borrower should be a well-established individual or company with adequate financial resources to withstand short-term fluctuations in the marketplace. The borrower s financial ratios and trends are favorable. The loans may be unsecured or supported by non-real estate collateral for which the value is more difficult to determine, represent a reasonable credit risk and require an average amount of account officer attention. The borrower s ability to repay unsecured credit is to be of unquestionable strength.

Pass (D): *Monitor:* Sufficient primary source of repayment and an acceptable secondary source of repayment. Acceptable business or individual credit, but the borrower s operations, cash flow or financial conditions evidence average levels of risk. These loans are considered to be collectable in full, but may require a greater-than-average amount of loan officer attention. Borrowers are capable of absorbing normal setbacks without failing to meet the terms of the loan agreement.

Special Mention: A Special Mention asset has potential weaknesses that deserve close monitoring. These potential weaknesses may result in a deterioration of the repayment prospects for the asset or in the institution s credit position at some future date. Special Mention assets are not adversely classified and do not expose an institution to sufficient risk to warrant adverse classification. The Special Mention classification should neither be a compromise between a pass grade and substandard, nor should it be a catch all grade to identify any loan that has a policy exception.

Substandard: A substandard asset is inadequately protected by the current sound worth and payment capacity of the obligor or the collateral pledged. Assets so classified must have a well-defined weakness or weaknesses that jeopardize the liquidation of the debt. Assets classified as substandard are characterized by the distinct possibility that the institution will sustain some loss if the deficiencies are not corrected.

Formula Classified: Formula classified loans are all loans and credit cards delinquent 90 days and over which have yet to be formally classified Special Mention, Substandard or Doubtful by the Bank s Loan Committee. In most instances, the monthly formula total is comprised primarily of real estate loans, consumer loans and credit cards. Commercial loans are typically formally classified by the Loan Committee no later than their 90-day delinquency, and thus do not become part of the formula classification. Real estate loans 90-days delinquent are in the foreclosure process, which is typically completed within another 60 days, and thus are not formally classified during this period.

Doubtful: A loan with weaknesses well enough defined that eventual repayment in full, on the basis of currently existing facts, conditions and values, is highly questionable, even though certain factors may be present which could improve the status of the loan. The probability of some loss is extremely high, but because of certain known factors that may work to the advantage of strengthening of the assets (i.e. capital injection, perfecting liens on additional collateral, refinancing plans, etc.), its classification as an estimated loss is deferred until its more exact status can be determined.

Loss: Loans classified as Loss are considered uncollectible, and are either unsecured or are supported by collateral that is of little to no value. As such, their continuance as recorded assets is not warranted. While this classification does not mandate that a loan has no ultimate recovery value, losses should be taken in the period during which these loans are deemed to be uncollectible. Loans identified as loss are immediately approved for charge-off. The Bank may refer loans to outside collection agencies, attorneys, or its internal collection division to continue collection efforts. Any subsequent recoveries are credited to the Allowance for Loan Losses.

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Set forth below is a summary of the Bank s activity in the allowance for loan losses during the three and nine months ended September 30, 2013, and the year ended December 31, 2012:

	Three Months Ended September 30, 2013	Nine months Ended September 30, 2013	Year Ended December 31, 2012
		(Dollars in thousands)	
Balance, beginning of period	$ 11,675	$ 12,228	$ 11,101
Provision for loan losses	900	1,195	3,900
Recoveries on loans previously charged off	493	1,374	3,294
Charged off loans	(1,073)	(2,802)	(6,067)
Balance, end of period	$ 11,995	$ 11,995	$ 12,228

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Set forth below is information regarding loan balances and the related allowance for loan losses, by portfolio type, for the three- and nine-month periods ended September 30, 2013, and the year ended December 31, 2012, respectively.

	Commercial	Consumer Residential Mortgages	Consumer Other	Total
		(Dollars in thousands)		
Nine months Ended September 30, 2013				
Allowance for loan losses:				
Balance at beginning of period	$ 6,251	$ 1,453	$ 4,524	$ 12,228
Charge-offs	(95)	(164)	(2,543)	(2,802)
Recoveries	61	138	1,175	1,374
Provision	(849)	(302)	2,346	1,195
Balance at end of period	$ 5,368	$ 1,125	$ 5,502	$ 11,995
Three Months Ended September 30, 2013				
Allowance for loan losses:				
Balance at beginning of quarter	$ 5,449	$ 1,066	$ 5,160	$ 11,675
Charge-offs	(25)	(134)	(914)	(1,073)
Recoveries	8	135	350	493
Provision	(64)	58	906	900
Balance at end of quarter	$ 5,368	$ 1,125	$ 5,502	$ 11,995
Allowance balance at end of quarter related to:				
Loans individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0
Loans collectively evaluated for impairment	$ 5,368	$ 1,125	$ 5,502	$ 11,995
Loan balances at end of quarter:				
Loans individually evaluated for impairment	10,323	6,293	226	16,842
Loans collectively evaluated for impairment	547,595	152,007	143,402	843,004
Ending Balance	$ 557,918	$ 158,300	$ 143,628	$ 859,846
Year Ended December 31, 2012				
Allowance for loan losses:				
Balance at beginning of year	$ 6,654	$ 318	$ 4,129	$ 11,101
Charge-offs	(1,320)	(68)	(4,679)	(6,067)
Recoveries	159	3	3,132	3,294
Provision	758	1,200	1,942	3,900
Balance at end of year	$ 6,251	$ 1,453	$ 4,524	$ 12,228
Allowance balance at end of year related to:				

Loans individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0
Loans collectively evaluated for impairment	$ 6,251	$ 1,453	$ 4,524	$ 12,228
Loan balances at end of year:				
Loans individually evaluated for impairment	9,367	7,242	234	16,843
Loans collectively evaluated for impairment	447,954	158,743	139,405	746,102
Ending Balance	$ 457,321	$ 165,985	$ 139,639	$ 762,945

Impairment is measured on a loan-by-loan basis for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral (if the loan is collateral-dependent). Large groups of smaller-balance homogeneous loans are collectively evaluated for impairment. The Bank performs direct write-downs of impaired loans with a charge to the allocated component of the allowance, therefore reducing the allocated component of the allowance to zero at the end of each reporting period.

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Credit Quality

The following table provides a summary of the delinquency status of the Bank s loans by portfolio type:

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater	Total Past Due	Current	Total Loans Outstanding
			(Dollars in thousands)			
September 30, 2013						
Commercial						
Commercial & industrial	$ 605	$ 37	$ 465	$ 1,107	$ 179,447	$ 180,554
Commercial mortgage	1,293	1,314	4,769	7,376	369,230	376,606
Commercial construction	0	0	0	0	758	758
Total commercial	1,898	1,351	5,234	8,483	549,435	557,918
Consumer						
Residential mortgage	9,194	5,142	3,618	17,954	139,233	157,187
Home equity	17	0	0	17	1,096	1,113
Automobile	246	16	0	262	7,294	7,556
Other consumer [1]	2,328	1,025	981	4,334	131,738	136,072
Total consumer	11,785	6,183	4,599	22,567	279,361	301,928
Total	$ 13,683	$ 7,534	$ 9,833	$ 31,050	$ 828,796	$ 859,846
December 31, 2012						
Commercial						
Commercial & industrial	$ 65	$ 222	$ 521	$ 808	$ 138,143	$ 138,951
Commercial mortgage	2,050	1,403	5,963	9,416	305,046	314,462
Commercial construction	0	0	0	0	3,908	3,908
Total commercial	2,115	1,625	6,484	10,224	447,097	457,321
Consumer						
Residential mortgage	8,705	4,513	5,190	18,408	146,366	164,774
Home equity	0	135	0	135	1,076	1,211
Automobile	314	76	0	390	7,837	8,227
Other consumer [1]	2,389	948	1,187	4,524	126,888	131,412
Total consumer	11,408	5,672	6,377	23,457	282,167	305,624
Total	$ 13,523	$ 7,297	$ 12,861	$ 33,681	$ 729,264	$ 762,945

[1] Comprised of other revolving credit, installment loans, and overdrafts.

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Generally, the accrual of interest on a loan is discontinued when principal or interest payments become more than 90 days past due, unless management believes the loan is adequately collateralized and is in the process of collection. When a loan is placed on non-accrual status, previously accrued but unpaid interest is reversed against current income. Subsequent collections of cash are applied as principal reductions when received, except when the ultimate collectability of principal is probable, in which case interest payments are credited to income. Non-accrual loans may be restored to accrual status when principal and interest become current and full repayment is expected. The following table provides information as of September 30, 2013, and December 31, 2012, with respect to loans on non-accrual status, by portfolio type:

	September 30, 2013	December 31, 2012
	(Dollars in thousands)	
Non-accrual loans:		
Commercial		
Commercial & industrial	$ 319	$ 685
Commercial mortgage	6,379	7,977
Commercial construction	0	0
Total commercial	6,698	8,662
Consumer		
Residential mortgage	6,229	7,166
Home equity	64	76
Automobile	0	0
Other consumer [1]	226	234
Total consumer	6,519	7,476
Total non-accrual loans	$ 13,217	$ 16,138

[1] Comprised of other revolving credit, installment loans, and overdrafts.

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The Bank classifies its loan portfolios using internal credit quality ratings, as discussed above under *Allowance for Loan Losses*. The following table provides a summary of loans by portfolio type and the Bank s internal credit quality ratings as of September 30, 2013, and December 31, 2012.

	September 30, 2013	December 31, 2012	Increase (Decrease)
		(Dollars in thousands)	
Pass:			
Commercial & industrial	$ 176,602	$ 123,046	$ 53,556
Commercial mortgage	352,971	290,307	62,664
Commercial construction	758	3,908	(3,150)
Residential mortgage	152,910	158,408	(5,498)
Home equity	1,113	1,211	(98)
Automobile	7,556	8,227	(671)
Other consumer	135,199	130,345	4,854
Total pass loans	$ 827,109	$ 715,452	$ 111,657
Special Mention:			
Commercial & industrial	$ 416	$ 3,752	$ (3,336)
Commercial mortgage	13,747	6,839	6,908
Commercial construction	0	0	0
Residential mortgage	0	0	0
Home equity	0	0	0
Automobile	0	0	0
Other consumer	0	0	0
Total special mention loans	$ 14,163	$ 10,591	$ 3,572
Substandard:			
Commercial & industrial	$ 3,390	$ 12,153	$ (8,763)
Commercial mortgage	9,768	17,316	(7,548)
Commercial construction	0	0	0
Residential mortgage	78	370	(292)
Home equity	0	0	0
Automobile	0	0	0
Other consumer	0	26	(26)
Total substandard loans	$ 13,236	$ 29,865	$ (16,629)
Formula Classified:			
Commercial & industrial	$ 146	$ 0	$ 146
Commercial mortgage	120	0	120
Commercial construction	0	0	0
Residential mortgage	4,199	5,996	(1,797)
Home equity	0	0	0
Automobile	0	0	0
Other consumer	873	1,041	(168)
Total formula classified loans	$ 5,338	$ 7,037	$ (1,699)

Doubtful:			
Commercial & industrial	$ 0	$ 0	$ 0
Commercial mortgage	0	0	0
Commercial construction	0	0	0
Residential mortgage	0	0	0
Home equity	0	0	0
Automobile	0	0	0
Other consumer	0	0	0
Total doubtful loans	$ 0	$ 0	$ 0
Total outstanding loans, gross	$ 859,846	$ 762,945	$ 96,901

As the above table indicates, the Bank s total loans approximated $859.8 million at September 30, 2013, up from $762.9 million at December 31, 2012. The disaggregation of the portfolio by risk rating in the table reflects the following changes between December 31, 2012, and September 30, 2013:

Loans rated pass increased by $111.7 million to $827.1 million at September 30, 2013, up from $715.5 million at December 31, 2012. The increase is primarily in commercial mortgages, which grew by $62.7 million, commercial & industrial loans, which increased by $53.6 million, and other consumer loans (consisting of other revolving credit, installment loans, and overdrafts), which increased by $4.9 million. This is due to various large loans originated in the California region and in Guam, as well as reclassifications from the substandard and special mention categories, along with an expansion in other consumer loans primarily due to a Summer consumer loan promotion. These were offset by a decrease in commercial construction loans by $3.2 million, due to the reclassification of loans that completed construction to commercial mortgage. Residential mortgages decreased by $5.5 million, automobile loans by $671 thousand and home equity loans by $98 thousand due to loan payoffs and pay downs.

The special mention category increased by $3.6 million at September 30, 2013, compared to December 31, 2012. This is attributed to an increase in special mention commercial mortgage loans of $6.9 million, primarily as a result of the downgrade of a $7.8 million loan relationship from pass. This is offset by a drop in special mention commercial & industrial loans by $3.3 million, resulting primarily from the upgrade of a $3.0 million loan relationship to pass.

Loans classified as substandard decreased by $16.6 million to $13.2 million at September 30, 2013, from $29.9 million at December 31, 2012. The decrease was mainly in commercial & industrial loans due to the upgrade of a $2.9 million loan relationship to pass and payoffs of $6.0 million. Further, commercial mortgage loans classified as substandard dropped by $7.5 million due primarily to the upgrade of a $6.8 million loan relationship to pass.

The formula classified category decreased by $1.7 million during the period, resulting primarily from payoff and pay downs of residential mortgage loans.

Impaired Loans

A loan is considered impaired when, based on current information and events, it is probable that the Bank will be unable to collect the scheduled payments of principal and interest when due according to the contractual terms of the loan agreement. Factors considered by management in determining impairment include payment status, collateral value, and the probability of collecting scheduled principal and interest payments when due. Loans that experience insignificant payment delays and payment shortfalls generally are not classified as impaired. Management determines the significance of payment delays and payment shortfalls on a case-by-case basis, taking into consideration all of the circumstances surrounding the loan and the borrower, including the length of the delay, the reasons for the delay, the borrower s prior payment record, and the amount of the shortfall in relation to the principal and interest owed.

Impaired loans include loans that are in non-accrual status and other loans that have been modified in Troubled Debt Restructurings (TDRs, where economic concessions have been granted to borrowers experiencing financial difficulties). These concessions typically result from the Bank s loss mitigation actions, and could include reductions in

the interest rate, payment extensions, forbearance, or other actions taken with the intention to maximize collections.

The following table sets forth information regarding non-accrual loans and restructured loans, at September 30, 2013, and December 31, 2012:

	September 30, 2013	December 31, 2012
	(Dollars in thousands)	
Impaired loans:		
Restructured loans:		
Non-accruing restructured loans	$ 5,676	$ 5,970
Accruing restructured loans	3,625	705
Total restructured loans	9,301	6,675
Other non-accruing impaired loans	7,541	10,168
Other accruing impaired loans	0	0
Total impaired loans	$ 16,842	$ 16,843
Impaired loans less than 90 days delinquent and included in total impaired loans	$ 7,889	$ 6,058

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The table below contains additional information with respect to impaired loans, by portfolio type, for the nine months ended September 30, 2013, and the year ended December 31, 2012:

	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Income Recognized
		(Dollars in thousands)		
September 30, 2013, With no related allowance recorded:				
Commercial & industrial	$ 3,469	$ 3,622	$ 3,141	$ 16
Commercial mortgage	6,854	8,569	7,611	2
Commercial construction	0	0	0	0
Residential mortgage	6,229	6,327	6,801	0
Home equity	64	64	70	0
Automobile	0	0	0	0
Other consumer	226	235	225	0
Total impaired loans with no related allowance	$ 16,842	$ 18,817	$ 17,848	$ 18
September 30, 2013, With an allowance recorded:				
Commercial & industrial	$ 0	$ 0	$ 0	$ 0
Commercial mortgage	0	0	0	0
Commercial construction	0	0	0	0
Residential mortgage	0	0	0	0
Home equity	0	0	0	0
Automobile	0	0	0	0
Other consumer	0	0	0	0
Total impaired loans with an allowance recorded	$ 0	$ 0	$ 0	$ 0
December 31, 2012, With no related allowance recorded:				
Commercial & industrial	$ 822	$ 975	$ 778	$ 29
Commercial mortgage	8,545	10,229	10,204	450
Commercial construction	0	0	925	0
Residential mortgage	7,166	7,264	3,313	249
Home equity	76	76	33	2
Automobile	0	0	0	0
Other consumer	234	243	191	8
Total impaired loans with no related allowance	$ 16,843	$ 18,787	$ 15,444	$ 738
December 31, 2012, With an allowance recorded:				
Commercial & industrial	$ 0	$ 0	$ 0	$ 0
Commercial mortgage	0	0	0	0
Commercial construction	0	0	0	0
Residential mortgage	0	0	0	0
Home equity	0	0	0	0

Automobile		0		0		0		0
Other consumer		0		0		0		0
Total impaired loans with an allowance recorded	$	0	$	0	$	0	$	0

Impairment is measured on a loan-by-loan basis for commercial and real estate loans by either the present value of expected future cash flows discounted at the loan s effective interest rate, the loan s obtainable market price, or the fair value of the collateral (if the loan is collateral-dependent). Large groups of smaller-balance, homogeneous loans are collectively evaluated for impairment. The Bank performs direct write-downs of impaired loans with a charge to the allocated component of the allowance for loan losses, thereby reducing the allocated component of the allowance to zero at the end of each reporting period.

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Troubled Debt Restructurings

In accordance with FASB s Accounting Standard Update No. 2011-02, *A Creditor s Determination of Whether a Restructuring is a Troubled Debt Restructuring* (ASU No. 2011-02), the Bank had $9.3 million of troubled debt restructurings (TDRs) as of September 30, 2013. The restructured loans recorded with the Bank have been modified for the purpose of alleviating temporary impairments to the borrower s financial condition. The modifications that the Bank has extended to borrowers have come in the form of a change in the amortization terms, reduction in the interest rate, and interest-only payments. The workout plan between the borrower and the Bank is designed to provide a bridge for cash flow shortfalls in the near term. As the borrower works through the near term issues, in most cases, the original contractual terms will be reinstated.

Additional information regarding performing and non-performing TDRs at September 30, 2013, and December 31, 2012, is set forth in the following table:

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Post-Modification Outstanding Recorded Investment	September 30, 2013	December 31, 2012
			(Dollars in thousands)		
Performing					
Residential mortgage	0	$ 0	$ 0	$ 0	$ 0
Commercial mortgage	6	3,982	3,982	3,625	706
Automobile	0	0	0	0	0
Consumer	0	0	0	0	0
	6	3,982	3,982	3,625	706
Nonperforming					
Residential mortgage	0	$ 0	$ 0	$ 0	$ 0
Commercial mortgage	7	10,120	8,805	5,676	5,970
Automobile	0	0	0	0	0
Consumer	0	0	0	0	0
	7	10,120	8,805	5,676	5,970
Total Troubled Debt Restructurings (TDRs)	13	$ 14,102	$ 12,787	$ 9,301	$ 6,676

Note 6 Commitments and Contingencies

The Bank utilizes facilities, equipment and land under various operating leases with terms ranging from 1 to 99 years. Some of these leases include scheduled rent increases. The total amount of the rent is being charged to expense on the straight-line method over the lease terms in accordance with ASC Topic 840 *Leases* . The Bank has recorded a deferred obligation of $745 thousand and $698 thousand as of September 30, 2013, and December 31, 2012, respectively, which is included within other liabilities, to reflect the excess of rent expense over cash paid on the

leases.

At September 30, 2013, future lease commitments under the above noncancelable operating leases were as follows:

Periods ending December 31,	
2013	$ 1,985
2014	1,379
2015	1,072
2016	886
Thereafter	19,709
Total	$ 25,289

The Bank leases certain facilities from two separate entities in which two of its directors have separate ownership interests. Lease payments made to these entities during the periods ended September 30, 2013, and December 31, 2012, approximated $278 thousand and $358 thousand, respectively.

Additionally, the Bank leases office space to third parties, with original lease terms ranging from 3 to 5 years and option periods ranging up to 15 years. At September 30, 2013, minimum future rents to be received under non-cancelable operating sublease agreements were $267, $54, $40, and $27 thousand for the periods ending December 2013, 2014, 2015 and 2016, respectively.

A summary of rental activities for the 9-month periods ended September 30, 2013, and September 30, 2012, is as follows:

	September 30, 2013	September 30, 2012
Rent expense	$ 1,748	$ 1,708
Less: sublease rentals	200	190
Net rent expense	$ 1,548	$ 1,518

The Bank is involved in certain legal actions and claims that arise in the ordinary course of business. Management believes that, as a result of its legal defenses and insurance arrangements, none of these matters is expected to have a material adverse effect on the Bank s or the Company s financial position, results of operations or cash flows.

Note 7 Minimum Regulatory Capital Requirements

The Bank is subject to various regulatory capital requirements administered by the United States federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank s and the Company s consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items, as calculated under regulatory accounting practices.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes that, as of September 30, 2013, and December 31, 2012, the Bank met all capital adequacy requirements to which it is subject.

As of September 30, 2013, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table.

There are no conditions or events since the notification that management believes have changed the Bank s category. The Bank s actual capital amounts and ratios as of September 30, 2013, and December 31, 2012, are also presented in the table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At September 30, 2013:						
Total capital (to Risk Weighted Assets)	$ 106,514	12.53%	$ 67,995	8.00%	$ 84,994	10.00%

Tier 1 capital (to Risk Weighted Assets)	$ 96,011	11.44%	$ 33,577	4.00%	$ 50,366	6.00%
Tier 1 capital (to Average Assets)	$ 96,011	7.31%	$ 52,569	4.00%	$ 65,711	5.00%
At December 31, 2012:						
Total capital (to Risk Weighted Assets)	$ 101,489	13.51%	$ 60,094	8.00%	$ 75,118	10.00%
Tier 1 capital (to Risk Weighted Assets)	$ 92,206	12.43%	$ 29,676	4.00%	$ 44,514	6.00%
Tier 1 capital (to Average Assets)	$ 92,206	7.40%	$ 49,854	4.00%	$ 62,317	5.00%

Note 8 Off-Balance-Sheet Activities

The Bank is a party to credit-related financial instruments with off-balance-sheet risk to meet the financing needs of its customers in the normal course of business. These financial instruments include commitments to extend credit, standby letters of credit, and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the consolidated financial statements.

The Bank s exposure to credit loss, in the event of nonperformance by the other parties to financial instruments for loan commitments and letters of credit, is represented by the contractual amount of these instruments. The Bank follows the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

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A summary of financial instruments with off-balance-sheet risk at September 30, 2013, and December 31, 2012, is as follows:

	September 30, 2013	December 31, 2012
Commitments to extend credit	$ 108,988	$ 100,007
Letters of credit:		
Standby letters of credit	$ 47,554	$ 26,178
Other letters of credit	2,342	3,030
Total	$ 49,896	$ 29,208

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. The commitments for some lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon extension of credit, is based on management s credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party or the shipment of merchandise from a third party. These letters of credit are primarily issued to support public and private borrowing arrangements. The majority of all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters-of-credit is essentially the same as that involved in extending loan facilities to customers, and similar credit underwriting standards are applied. The Bank generally holds collateral supporting those commitments.

The Bank considers its standby letters of credit to be payment guarantees. At September 30, 2013, the maximum undiscounted future payments that the Bank could be required to make for all outstanding letters of credit were $49.9 million. All of these arrangements mature within one year. The Bank has recourse to recover from the customer any amounts paid under these guarantees. Most of the guarantees are fully collateralized; however, several are unsecured. The Bank had not recorded any liabilities associated with these guarantees at September 30, 2013.

Mortgage loans serviced for others are not included in the accompanying consolidated statements of condition. The unpaid principal balances of mortgage loans serviced for others were $204.6 million and $197.4 million at September 30, 2013, and December 31, 2012, respectively. On September 30, 2013, and December 31, 2012, the Bank recorded mortgage servicing rights at their estimated fair value of $1.35 million and $1.29 million, respectively.

Note 9 Income Taxes

We record an amount equal to the tax credits, tax loss carry-forwards and tax deductions (tax benefits) that we believe will be available to us to offset or reduce the amounts of our income taxes in future periods as a deferred tax asset on our balance sheet. Under applicable federal and state income tax laws and regulations in the United States, such tax benefits will expire if not used within specified periods of time. Accordingly, the ability to fully use our deferred tax asset depends on the amount of taxable income that we generate during those time periods. At least once each year, or more frequently if warranted, we make estimates of future taxable income that we believe we are likely to generate

during those future periods. If we conclude, on the basis of those estimates and the amount of the tax benefits available to us, that it is more likely than not that we will be able to fully utilize those tax benefits prior to their expiration, we recognize the deferred tax asset in full on our balance sheet. On the other hand, if we conclude on the basis of those estimates and the amount of the tax benefits available to us that it has become more likely than not that we will be unable to utilize those tax benefits in full prior to their expiration, then we would establish a (or increase any existing) valuation allowance to reduce the deferred tax asset on our balance sheet to the amount which we believe we are more likely than not to be able to utilize. Such a reduction is implemented by recognizing a non-cash charge that would have the effect of increasing the provision, or reducing any credit, for income taxes that we would otherwise have recorded in our statements of operations. The determination of whether and the extent to which we will be able to utilize our deferred tax asset involves significant management judgments and assumptions that are subject to period-to-period changes as a result of changes in tax laws, changes in the market, or economic conditions that could affect our operating results or variances between our actual operating results and our projected operating results, as well as other factors.

A valuation allowance of $2.4 million has been provided at September 30, 2013, to reduce the deferred tax asset because, in management s opinion, it is more likely than not that these tax benefits will not be realized. The portion of the deferred tax asset with valuation allowance is attributable to a net operating loss carry forward from the Bank s California operations. The benefit of the net operating loss has already been realized as a result of the Guam income tax code.

The difference between the effective income tax expense and the income tax expense computed at the Guam statutory rate was due to nontaxable interest income earned on loans to the Government of Guam for each of the years ended December 31, 2012 and 2011.

The Bank files income tax returns in Guam, the CNMI and the State of California. The Bank is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years prior to 2007.

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Note 10 Fair Value of Assets and Liabilities

The Bank uses fair value measurements to record fair value adjustments to certain assets and liabilities and to determine fair value disclosures. In accordance with ASC Topic 820 *Fair Value Measurements and Disclosures* , the fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value is best determined based upon quoted market prices. However, in many instances there are no quoted market prices for the Bank s various financial instruments. In cases where quoted market prices are not available, fair values are based on estimates using present value or other valuation techniques. Those techniques are significantly affected by the assumptions used, including the discount rate and estimates of future cash flows. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instrument. The fair value guidance of ASC Topic 820 provides a consistent definition of fair value, which focuses on exit price in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under then-current market conditions. If there has been a significant decrease in the volume and level of activity for the asset or liability, a change in valuation technique or the use of multiple valuation techniques may be appropriate. In such instances, determining the price at which willing market participants would transact at the measurement date under then-current market conditions depends on the facts and circumstances, and requires the use of significant judgment. The fair value is a reasonable point within the range that is most representative of fair value under then-current market conditions.

Fair Value Hierarchy

In accordance with the guidance of ASC Topic 820, the Bank groups its financial assets and financial liabilities generally measured at fair value in three levels, based on the markets in which the assets and liabilities are traded and the reliability of the assumptions used to determine fair value.

Level 1: Valuation is based on quoted prices in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. Level 1 assets and liabilities generally include debt and equity securities that are traded in an active exchange market, as well as certain U.S. Treasury securities that are highly liquid and are actively traded in over-the-counter markets. Valuations are obtained from readily available pricing sources for market transactions involving identical assets or liabilities.

Level 2: Valuation is based on inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. The valuation may be based on quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3: Valuation is based on unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets and liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which determination of fair value requires significant management judgment or estimation.

A financial instrument s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement.

Financial assets measured at fair value on a recurring basis as of September 30, 2013, and December 31, 2012, are as follows:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total
At September 30, 2013				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 0	$ 8,472	$ 0	$ 8,472
U.S. government agency pool securities	0	55,920	0	55,920
U.S. government agency or GSE	0	108,442	0	108,442
Other assets:				
Mortgage Servicing Rights	0	0	1,350	1,350
Total assets	$ 0	$ 172,834	$ 1,350	$ 174,184
At December 31, 2012				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 0	$ 60,145	$ 0	$ 60,145
U.S. government agency pool securities	0	73,798	0	73,798
U.S. government agency or GSE	0	139,579	0	139,579
Other assets:				
Mortgage Servicing Rights	0	0	1,285	1,285
Total assets	$ 0	$ 273,522	$ 1,285	$ 274,807

There were no liabilities measured at fair value on a recurring basis as of September 30, 2013, and December 31, 2012.

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During the periods ended September 30, 2013, and December 31, 2012, the changes in Level 3 assets measured at fair value on a recurring basis are as follows:

	September 30, 2013		December 31, 2012	
Beginning balance	$	1,285	$	1,028
Realized and unrealized net gains:				
Included in net income		65		257
Included in other comprehensive income		0		0
Purchases, sales and issuances				
Purchases		0		0
Sales		0		0
Issuances		0		0
Ending balance	$	1,350	$	1,285

The valuation technique used for Level 3 assets in this category is their discounted cash flow. Inputs considered in determining Level 3 pricing include the anticipated prepayment rates, default rates, and the loss severity given a future default. Significant increases or decreases in any of those inputs in isolation would result in a significantly lower or higher fair value measurement. In general, a change in the assumption of the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity in an event of default.

The MSRs are priced with a discount rate composed of two components: a risk-free rate plus a risk premium. Future income is assumed to be received on active loans in line with the outstanding balance each month, multiplied by the difference between the parent and investor interest rates (the spread). For most of the mortgage loans serviced, the spread is 0.375%. We have discounted income net of expenses and tax from the projection month in which cash flows are expected to occur at a gross interest rate of 7.4% *per annum*. This rate has been built up using the Capital Asset Pricing Model (CAPM) approach. We have used a risk-free rate based on U.S. Federal Government bond yields at the valuation date (with a term appropriate to the future income from the loan portfolio), an assumed risk premium of 6.0% *per annum* and a beta of 1.0.

There were no transfers into or out of the Bank s Level 3 financial assets for the periods ended September 30, 2013, and December 31, 2012.

Fair Value on a Nonrecurring Basis

Under certain circumstances, the Bank makes adjustments to fair value for assets and liabilities even though they are not measured at fair value on an ongoing basis. The following table presents the financial instruments carried on the consolidated statements of condition by caption and by level in the fair value hierarchy at September 30, 2013, and December 31, 2012, for which a nonrecurring change in fair value has been recorded:

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Total

September 30, 2013								
Financial assets:								
Loans, net								
Impaired loans	$	0	$	0	$	0	$	0
Other assets								
Other real estate owned	$	0	$	4,538	$	0	$	4,538
December 31, 2012								
Financial assets:								
Loans, net								
Impaired loans	$	0	$	250	$	0	$	250
Other assets								
Other real estate owned	$	0	$	4,384	$	0	$	4,384

In accordance with the provisions of loan impairment guidance of ASC Subtopic 310-10-35, no loans were written down during the quarter ended September 30, 2013. The fair value of loans subject to write downs are estimated using the appraised value of the underlying collateral, discounted as necessary due to management s estimates of changes in economic conditions, less the estimated costs of selling the assets.

In accordance with the provisions of the Impairment or Disposal of Long-Lived Assets Subsections of ASC Subtopic 360 10, the Bank did not have any impairment or disposal of Long-Lived Assets during the quarter ended September 30, 2013. There were three properties foreclosed totaling $549 thousand that were booked into Other Real Estate Owned (OREO) during the quarter ended September 30, 2013. Four other OREO properties were sold during the quarter ended September 30, 2013, totaling $242 thousand. OREO losses during the quarter resulting from appraisals/sales deficiencies totaled $43 thousand. After allowing for the Reserve for OREO Losses of $37 thousand at the end of the quarter, the Other Real Estate Owned ending balance at September 30 was $4.5 million. Foreclosed assets subject to write downs is estimated using the appraised value of the underlying collateral, discounted as necessary due to management s estimates of changes in economic conditions, less the estimated costs to sell the assets.

The Bank also makes adjustments to nonfinancial assets and liabilities even though they are not measured at fair value on an ongoing basis. The Bank did not have nonfinancial assets or liabilities for which a nonrecurring change in fair value has been recorded during the periods ended September 30, 2013, and December 31, 2012.

The following methods and assumptions were used by the Bank in estimating fair value disclosures for financial instruments:

Cash and Cash Equivalents

The carrying amount of cash and short-term instruments approximates fair value based on the short-term nature of the assets.

Interest-Bearing Deposits in Banks

Fair values for other interest-bearing deposits are estimated using discounted cash flow analyses based on current interest rates or yields for similar types of deposits.

Investment Securities

When quoted prices are available in an active market, the Bank classifies the securities within Level 1 of the valuation hierarchy. Level 1 securities include highly liquid U.S. Government debt and equity securities.

If quoted market prices are not available, the Bank estimates fair values using pricing models and discounted cash flows that consider standard input factors such as observable market data, benchmark yields, interest rate volatilities, broker/dealer quotes, and credit spreads. Examples of such instruments, which would generally be classified within Level 2 of the valuation hierarchy, include U.S. GSE obligations, corporate bonds, and other securities. Mortgage-backed securities are included in Level 2 if observable inputs are available. In certain cases where there is limited activity or less transparency around inputs to the valuation, the Bank would classify those securities in Level 3. At September 30, 2013, and December 31, 2012, the Bank did not have any Level 3 securities.

Loans

For variable-rate loans that re-price frequently and with no significant change in credit risk, fair values are based on carrying values. Fair values for other loans are estimated using discounted cash flow analyses, using interest rates currently being offered for loans with similar terms to borrowers of similar credit quality. Fair values for nonperforming loans are estimated using discounted cash flow analyses or underlying collateral values, where applicable.

Mortgage Servicing Rights

The fair value of MSRs is determined using models which depend on estimates of prepayment rates and resultant weighted average lives of the MSRs and option-adjusted interest rate spread levels.

Deposit Liabilities

The fair values disclosed for demand deposits (for example, interest and non-interest checking, passbook savings and certain types of money market accounts) are, by definition, equal to the amount payable on demand at the reporting date (that is, their carrying amounts). Fair values for fixed-rate certificates of deposit are estimated using a discounted

cash flow calculation that applies current market interest rates on comparable instruments to a schedule of aggregated expected monthly maturities on time deposits.

Short-Term Borrowings

The carrying amounts of federal funds purchased and Federal Home Loan Bank (FHLB) advances maturing within ninety days approximate their fair values. The Bank had no short-term borrowings as of September 30, 2013.

Long-Term Borrowings

The fair value of FHLB advances maturing after ninety days is determined based on expected present value techniques using current market interest rates for advances with similar terms and remaining maturities.

Off-Balance Sheet Commitments and Contingent Liabilities

Management does not believe it is practicable to provide an estimate of fair value for off-balance sheet commitments or contingent liabilities because of the uncertainty involved in attempting to assess the likelihood and timing of a commitment being drawn upon, coupled with a lack of an established market for these instruments and the wide diversity of fee structures.

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Fair Value of Other Financial Instruments

The estimated fair values of the Bank s other financial instruments, excluding those assets recorded at fair value on a recurring basis on the Bank s consolidated statements of condition, are as follows:

		Estimated fair value			
($ in thousands)	Carrying amount	Level 1	Level 2	Level 3	Total
September 30, 2013					
Financial assets:					
Cash and cash equivalents	$ 248,837	$ 248,837	$ 0	$ 0	$ 248,837
Interest bearing deposits with banks	400	400	0	0	400
Investment securities held to maturity	91,460	0	92,728	0	92,728
Loans	845,612	0	0	836,439	836,439
Total	$ 1,186,309	$ 249,237	$ 92,728	$ 836,439	$ 1,178,404
Financial liabilities:					
Deposits	$ 1,314,323	$ 0	$ 1,314,204	$ 0	$ 1,314,204
Total	$ 1,314,323	$ 0	$ 1,314,204	$ 0	$ 1,314,204
December 31, 2012					
Financial assets:					
Cash and cash equivalents	$ 74,189	$ 74,189	$ 0	$ 0	$ 74,189
Interest bearing deposits with banks	150	150	0	0	150
Investment securities held to maturity	58,125	0	60,221	0	60,221
Loans	748,832	0	0	746,848	746,848
Total	$ 881,296	$ 74,339	$ 60,221	$ 746,848	$ 881,408
Financial liabilities:					
Deposits	$ 1,102,540	$ 0	$ 1,107,142	$ 0	$ 1,107,142
Federal Home Loan Bank advances	10,000	0	10,000	0	10,000
Total	$ 1,112,540	$ 0	$ 1,117,142	$ 0	$ 1,117,142

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

The following discussion provides information about the results of operations, financial condition, liquidity, and capital resources of the Company and its wholly-owned subsidiary, the Bank. This information is intended to facilitate the understanding and assessment of significant changes and trends related to our financial condition and the results of operations. This discussion and analysis should be read in conjunction with our consolidated financial statements and the accompanying notes presented elsewhere in this Quarterly Report.

Overview

BankGuam Holding Company (the Company) is a Guam corporation organized on October 29, 2010, to act as a holding company of Bank of Guam (the Bank), a 23-branch bank serving the communities in Guam, the Commonwealth of the Northern Mariana Islands (CNMI), the Federated States of Micronesia (FSM), the Republic of the Marshall Islands (RMI), the Republic of Palau (ROP), and San Francisco, California. On August 15, 2011, the Company acquired all of the outstanding common stock of the Bank in a holding company formation transaction.

Other than holding the shares of the Bank, the Company conducts no significant activities, although it is authorized, with the prior approval of its principal regulator, the Board of Governors of the Federal Reserve System (the Federal Reserve Board), to engage in a variety of activities related to the business of banking. Currently, substantially all of the Company s operations are conducted and substantially all of the assets are owned by the Bank, which accounts for substantially all of our consolidated revenues, expenses and operating income. The Bank s headquarters is located in Hagåtña, Guam, and the Bank provides a variety of financial services to individuals, businesses and government entities through its branch network. The Bank s primary deposit products are demand deposits, savings and time certificates of deposit, and its primary lending products are consumer, commercial and real estate loans. The Bank also provides many other financial services to its customers.

Summary of Operating Results

The following table provides unaudited comparative information with respect to our results of operations for the three-month and nine-month periods ended September 30, 2013 and 2012, respectively:

(unaudited)	Three months ended September 30,			Nine months ended September 30,		
	2013	2012	%	2013	2012	%
(dollars in thousands)	Amount	Amount	Change	Amount	Amount	Change
Interest income	$ 16,312	$ 15,619	4.4%	$ 47,455	$ 46,926	1.1%
Interest expense	1,122	1,407	(20.3)%	3,653	4,104	(11.0)%
Net interest income	15,190	14,212	6.9%	43,802	42,822	2.3%
Provision for loan losses	900	975	(7.7)%	1,195	2,925	(59.1)%
Net interest income after provision for loan losses	14,290	13,237	8.0%	42,607	39,897	6.8%
Total non-interest income	2,574	2,710	(5.0)%	8,588	8,562	0.3%
Total non-interest expense	13,522	13,266	1.9%	40,858	39,146	4.4%
Net income before income taxes	3,342	2,681	24.7%	10,337	9,313	11.0%

Provision for income taxes		1,007		710	41.8%		3,063		2,553	20.0%
Net income	$	2,335	$	1,971	18.5%	$	7,274	$	6,760	7.6%
Net income per common share										
Basic	$	0.27	$	0.22	22.7%	$	0.83	$	0.77	7.8%
Diluted	$	0.27	$	0.22	22.7%	$	0.83	$	0.77	7.8%

As the above table indicates, our net income increased in the three months ended September 30, 2013, as compared to the corresponding period in 2012. In the three months ended September 30, 2013, we recorded net income after taxes of $2.3 million, up $364 thousand (or 18.5%) as compared to the same period in 2012. These results were most significantly impacted by: (i) an increase in interest income of $693 thousand resulting from the expansion of our loan portfolio; (ii) an increase in our provision for income taxes of $297 thousand due to higher pre-tax net income; and, (iii) a reduction in our interest expense by $285 thousand due to a reduction of the interest rate paid on savings deposits.

During the first nine months of 2013 our net income after income taxes increased to $7.3 million from $6.8 million during the corresponding period of 2012. This increase of $514 thousand (or 7.6%) was primarily due to a reversal in our allowance for loan losses by $1.7 million, resulting in a reduction of our provision for loan losses to $1.2 million from $2.9 million in the first nine months of 2012. This reduction was due to an improvement in the performance of our loan portfolio, specifically related to a substantial decrease in loans classified as substandard, a decrease in delinquency rates and a reduction in net charge-offs. The decrease in the provision for loan losses was supplemented by an increase of $980 thousand in net interest income before the provision, but was largely offset by a decrease of $1.7 million in net non-interest income, and partially offset by an increase of $510 thousand in income tax expense. A large part of the decrease in net non-interest income was due to an increase of $733 thousand in the non-interest expense of the salaries that we pay and the benefits that we provide to our employees. An increase of $504 thousand in occupancy expense, due to an accounting adjustment for depreciation that was previously disclosed, and an increase of $566 thousand in other general operating expense associated with higher OREO expenses, offset by lower legal expenses and lower sundry losses, also reduced our potential net income.

The following table shows the decrease in our annualized net interest margin during the nine months ended September 30, 2013, and the modest increase in that measure during the three months ended on that same date. However, the growth in total assets and the conversion of non-interest earning assets to interest earning assets held the annualized return on average assets constant at 0.75% in the nine months ended September 30, 2012 and 2013, and to increase from 0.63% in the three months ended September 30, 2012, to 0.71% in that same three months in 2013. For the same

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reasons, the annualized return on average equity increased from 9.78% to 10.26% in the nine months ended September 30, 2012 and 2013, respectively, while that same measure increased from 8.33% in the three months ended September 30, 2012, to 9.99% in the three months ended September 30, 2013.

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net interest margin	4.87%	4.85%	4.77%	5.11%
Return on average assets	0.71%	0.63%	0.75%	0.75%
Return on average equity	9.99%	8.33%	10.26%	9.78%

Critical Accounting Policies

The Company s significant accounting policies are set forth in Note 1 in the Notes to the Company s Annual Report on Form 10-K for 2012 filed with the SEC on March 21, 2013, and Note 2 of Item 1 in this report. Our unaudited condensed consolidated financial statements are prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) and general practices in the banking industry. Certain of those accounting policies are considered critical accounting policies because they require us to make assumptions and judgments regarding circumstances or trends that could affect the carrying values of our material assets, such as assumptions regarding economic conditions or trends that could impact our ability to fully collect our outstanding loans or ultimately realize the carrying values of certain of our other assets, such as securities that are available for sale. If adverse changes were to occur in the events, trends or other circumstances on which our assumptions or judgments have been based, or other unanticipated events were to happen that might affect our operating results, it could become necessary under GAAP for us to reduce the carrying values of the affected assets on our Statement of Condition. In addition, because reductions in the carrying values of assets are sometimes effectuated by or require charges to income, such reductions also may have the effect of reducing our income. The following is a brief description of the Company s current accounting policies involving significant valuation judgments:

Loans and Interest on Loans

Loan receivables that management has the intent and ability to hold for the foreseeable future or until maturity or payoff are reported at their outstanding unpaid principal balances, reduced by any charge-offs of specific valuation allowances and net of any deferred fees or costs on originated loans, or unamortized premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are capitalized and recognized as an adjustment in income over the life of the related loan.

Loans on which the accrual of interest has been discontinued are designated as non-accruing loans. The accrual of interest on loans is discontinued when principal and/or interest is past due 90 days or more based on the contractual terms of the loan and/or when, in the opinion of management, there is a reasonable doubt as to collectability, unless such loans are well-collateralized and in the process of collection. When loans are placed in non-accrual status, all interest previously accrued but not collected is reversed as a charge against current period interest income. Subsequent payments received on such loans are generally applied as a reduction to the loan principal balance, unless the likelihood of further loss is remote whereby cash interest payments may be recorded during the time the loan is on non-accrual status. Interest accruals are resumed on such loans only when they are brought current with respect to interest and principal and when, in the judgment of management, all remaining principal and interest is estimated to be fully collectible, there has been at least six months of sustained repayment performance since the loan was placed on non-accrual, and/or management believes, based on current information, that such loan is no longer impaired.

Management considers a loan to be impaired when, based on current information and events, it is probable that the Bank will be unable to collect all of the amounts due according to the contractual terms of the loan agreement. Measurement of impairment is based on the expected future cash flows of an impaired loan, which are discounted at the loan s original effective interest rate, or measured by reference to an observable market value, if one exists, or the fair value of the collateral for a collateral-dependent loan. The Bank performs direct write-downs of impaired loans with a charge to the allocated component of the allowance for loan losses, thereby reducing the allocated component of the allowance to zero at the end of each reporting period.

Allowance for Loan Losses

The Bank maintains its allowance for loan losses at a level which, in management s judgment, is adequate to absorb credit losses inherent in the loan portfolio as of the balance sheet date. The amount of the allowance is based on management s periodic evaluation of the collectability of the loan portfolio, including the nature and volume of the portfolio, credit concentrations, trends in historical loss experience, the level of certain classified and impaired loans, and economic conditions and the related impact on specific borrowers that may affect the borrower s ability to repay. The allowance is increased by provisions for loan losses, which are charged against net interest earnings, and reduced by charge-offs, net of recoveries. Changes in the allowance relating to impaired loans are charged or credited to the allowance for loan losses. Because of uncertainties in the estimation process, management s estimate of credit losses inherent in the loan portfolio and the related allowance may change.

Other Real Estate Owned

Real estate and other property acquired in full or partial settlement of loan obligations is referred to as other real estate owned (OREO). OREO is originally recorded in the Bank s unaudited condensed financial statements at the lower of the carrying amount of the loan or the fair value of the property, less any estimated costs to sell the underlying assets. When property is acquired through foreclosure or surrendered in lieu of foreclosure, the Bank measures the fair value of the property acquired against its recorded investment in the loan. If the fair value of the property at the time of acquisition is less than the recorded investment in the loan, the difference is charged to the allowance for loan losses. Any subsequent fluctuations in the fair value of the OREO are recorded against a valuation allowance for other real estate owned, established through a charge to non-interest expense. All related operating or maintenance costs are charged to non-interest expense as incurred. Any subsequent gains or losses on the sale of OREO are recorded in other income or expense as incurred.

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Investment Securities

In accordance with U.S. GAAP, securities are classified in three categories and accounted for as follows: (i) securities that the Bank has the intent and ability to hold to maturity are classified as held-to-maturity and are measured at amortized cost; (ii) securities bought and held principally for the purpose of selling in the near term are classified as trading securities and are measured at fair value, with unrealized gains and losses reflected in earnings; and, (iii) securities not classified as either held-to-maturity or trading are classified as available-for-sale securities and are measured at fair value, with unrealized gains and losses, net of applicable taxes, reported as a separate component of stockholders equity. Where available, the fair values of available-for-sale securities are based on quoted market prices. If quoted market prices are not available, fair values are estimated from the quoted prices of similar instruments or through the use of other observable data supporting a valuation model. Gains and losses on sales of investment securities are determined on the specific identification method. Premiums and discounts are amortized or accreted using the interest method over the expected lives of the related securities. The Bank does not hold securities for trading purposes.

Results of Operations

Net Interest Income

Net interest income, the primary component of the Bank s income, refers to the difference between the interest earned on loans, investment securities and other interest-earning assets, and the interest paid on deposits and other borrowed funds. Our interest income and interest expense are affected by a number of factors, some of which are outside of our control, including national and local economic conditions, the monetary policies of the Federal Reserve Board which affect interest rates, competition in the marketplace for loans and deposits, the demand for loans and the ability of borrowers to meet their payment obligations. Net interest income, when expressed as a percentage of average earning assets, is a banking organization s net interest margin.

The following table sets forth our interest income, interest expense and net interest income, and our annualized net interest margin for the three-month and nine-month periods ended September 30, 2013 and 2012, respectively:

	Three months ended September 30,			Nine months ended September 30,		
	2013	2012	%	2013	2012	%
(dollars in thousands)	Amount	Amount	Change	Amount	Amount	Change
Interest income	$ 16,312	$ 15,619	4.4%	$ 47,455	$ 46,926	1.1%
Interest expense	1,122	1,407	(20.3)%	3,653	4,104	(11.0)%
Net interest income	$ 15,190	$ 14,212	6.9%	$ 43,802	$ 42,822	2.3%
Net interest margin	4.87%	4.85%	0.02%	4.77%	5.11%	(0.34)%

Net interest income increased by 6.9% for the three months and increased by 2.3% for the nine months ended September 30, 2013, as compared to the respective corresponding periods in 2012.

For the three months ended September 30, 2013, net interest income rose by $978 thousand as compared to the same period in 2012. Total interest income increased by $693 thousand, principally because of a $1.0 million increase in interest earned on loans, which was partially offset by a $287 thousand decrease in interest from investment securities. The increase in net interest income was augmented by the decrease in total interest expense of $285 thousand, which

was due to the decrease in interest rates paid on savings accounts, but also to the elimination of interest payments on other borrowed funds.

For the nine months ended September 30, 2013, net interest income rose by $980 thousand as compared to the same period in 2012, with a $529 thousand increase in total interest income supplemented by a $451 thousand decrease in total interest expense. The increase in total interest income during the nine months ended September 30 , 2013, was principally because of the $908 thousand increase in interest income from loans, partially offset by a decrease of $315 thousand in interest income from investment securities, while the decrease in total interest expense was primarily due to the reduction of $229 thousand in interest paid on savings deposits and the $217 thousand decrease in interest paid on other borrowings when compared to the same period in 2012.

As indicated in the above table, our net interest margin for the three months ended September 30, 2013, was 4.87%, an increase of 0.02% from the 4.85% margin during the third quarter of 2012. For the nine months ended September 30, 2013, the net interest margin decreased by 0.34% to 4.77% as compared to the 5.11% margin in the corresponding nine months in 2012.

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Average Balances

Distribution, Rate and Yield

The following table sets forth information regarding our average balance sheet, annualized yields on interest earning assets and interest rates on interest-bearing liabilities, the interest rate spread and the interest rate margin for the nine month period ended September 30, 2013 and 2012:

	Three months ended September 30,					
(dollars in thousands)	2013 Average balance	2013 Interest earned/paid	2013 Average yield/rate	2012 Average balance	2012 Interest earned/paid	2012 Average yield/rate
Interest earning assets:						
Short term investments [1]	$ 115,793	$ 53	0.18%	$ 125,557	$ 79	0.25%
Investment securities [2]	277,592	1,179	1.70%	304,654	1,466	1.92%
Loans [3]	853,725	15,080	7.07%	741,998	14,074	7.59%
Total interest earning assets	1,247,110	16,312	5.23%	1,172,209	15,619	5.33%
Non-interest earning assets	67,888			74,615		
Total Assets	$ 1,314,998			$ 1,246,824		
Interest-bearing liabilities:						
Interest-bearing checking accounts	$ 119,789	34	0.11%	$ 111,210	68	0.24%
Money market and savings accounts	730,514	1,030	0.56%	679,661	1,187	0.70%
Certificates of deposit	54,533	58	0.43%	56,313	52	0.38%
Other borrowings	0	0	0.00%	10,000	100	3.96%
Total interest-bearing liabilities	904,836	1,122	0.50%	857,184	1,407	0.66%
Non-interest-bearing liabilities	316,710			295,021		
Total Liabilities	1,221,546			1,152,205		
Stockholders equity	93,452			94,619		
Total Liabilities and Stockholders equity	$ 1,314,998			$ 1,246,824		
Net interest income		$ 15,190			$ 14,212	
Interest rate spread			4.73%			4.67%
Net interest margin			4.87%			4.85%

	Nine months ended September 30,					
(dollars in thousands)	2013 Average	2013 Interest	2013 Average	2012 Average	2012 Interest	2012 Average

	balance	earned/paid	yield/rate	balance	earned/paid	yield/rate
Interest earning assets:						
Short term investments [1]	$ 105,384	$ 186	0.24%	$ 90,627	$ 250	0.37%
Investment securities [2]	297,805	3,817	1.71%	285,161	4,132	1.93%
Loans [3]	820,005	43,452	7.07%	741,637	42,544	7.57%
Total interest earning assets	1,223,194	47,455	5.17%	1,117,425	46,926	5.55%
Non-interest earning assets	68,400			81,422		
Total Assets	$ 1,291,594			$ 1,198,847		
Interest-bearing liabilities:						
Interest-bearing checking accounts	$ 119,532	137	0.15%	$ 101,976	181	0.24%
Money market and savings accounts	710,681	3,265	0.61%	657,248	3,464	0.70%
Certificates of deposit	55,236	171	0.41%	58,477	161	0.37%
Other borrowings	2,222	80	4.79%	10,000	298	3.92%
Total interest-bearing liabilities	887,671	3,653	0.55%	827,701	4,104	0.66%
Non-interest-bearing liabilities	309,348			278,955		
Total Liabilities	1,197,019			1,106,656		
Stockholders equity	94,575			92,191		
Total Liabilities and Stockholders equity	$ 1,291,594			$ 1,198,847		
Net interest income		$ 43,802			$ 42,822	
Interest rate spread			4.62%			4.89%
Net interest margin			4.77%			5.11%

(1) Short term investments consist of federal funds sold and interest-bearing deposits that we maintain with other financial institutions.

(2) Includes all investment securities in the Available-for-Sale and the Held-to-Maturity classifications.

(3) Loans include the average balance of non-accrual loans.

For the three months ended September 30, 2013, our total average assets increased by $68.2 million, or 5.5%, in comparison to the same three-month period in 2012. This increase was the result of a $74.9 million increase in our average total interest earning assets, offset by a decrease of $6.7 million in our average non-interest earning assets. The increase in average total interest earning assets was driven by a $111.7 million increase in our average loan portfolio, offset by a $27.1 million decrease in average investment securities and a $9.8 million decrease in average short term investments. The growth in our average total assets was funded by increases in both average total interest-bearing liabilities and average non-interest-bearing liabilities. The increase of $47.7 million in average total interest-bearing liabilities was the result of a $50.9 million increase in average money market and savings accounts and an $8.6 million increase in average interest-bearing checking accounts, offset by a decrease of $10.0 million in average other borrowings and a decrease of $1.8 million in average certificate of deposit balances. This increase in average total interest-bearing liabilities was partially the result of $140.1 million in the temporary deposit of $112.8 million in bond funds awaiting investment and $27.3 million in retirement fund investments pending distribution. The $21.7 million increase in average non-interest-bearing liabilities was partially due to an increase of $18.2 million in average non-interest-bearing demand deposits and an increase of $1.0 million in average income tax reserves, with the remainder of the variance in average other non-interest-bearing liabilities, including overdraft liabilities, holdover liabilities and other categories. The overall increase in average total liabilities of $69.3 million was partially offset by a decrease of $1.2 million in average stockholders equity, principally due to a decrease in average other comprehensive income, resulting in an increase of $68.2 million in average total liabilities and stockholders equity.

Our net interest spread and net interest margin during the three months ended September 30, 2013, increased by 0.06% and 0.02%, respectively, from the year-earlier period. The increase in our net interest spread was due to a decrease of 0.10% in our yield on average interest earning assets, accompanied by a decrease of 0.16% in our average cost of average interest-bearing liabilities. The increase in our net interest margin was due to an increase of $978 thousand in our net interest income, attenuated by a $74.9 million increase in average total interest earning assets.

For the nine months ended September 30, 2013, our total average interest earning assets increased by $105.8 million as compared to the same period in 2012, comprised of the $78.4 million increase in our average loan portfolio, the $14.8 million increase in average short term investments, and the $12.6 million increase in average investment securities portfolio. The overall growth in average interest earning assets was the result of growth in our deposit base, part of which is sustained, but part of which was the result of large depository balances of bond proceeds held in trust awaiting investment and part due to the liquidation of public retirement fund investments held in depository accounts awaiting disbursement. In the same nine month period ended September 30, 2013, average total interest-bearing liabilities increased by $60.0 million, largely attributed to the $53.4 million increase in average money market and savings deposits, coupled with the $17.6 million increase in average interest-bearing checking account balances. These were, however, partially offset by the $3.2 million decrease in average certificates of deposit and the $7.8 million decrease in average other borrowings as compared to the same period in 2012. Average non-interest-bearing liabilities, primarily in checking accounts, increased by $30.4 million during the first nine months of 2013 as compared to the same period in 2012.

Our net interest spread and net interest margin in the nine months ended September 30, 2013, decreased by 0.27% and 0.34%, respectively, as compared to the same period in 2012. These decreases are primarily attributed to the 0.38% drop in our yield on total interest earning assets, led by the 0.50% decline in our loan yields, and only partially offset by the overall 0.11% decline in our cost of funds.

Provision for Loan Losses

We maintain allowances to provide for possible loan losses that occur from time to time as an incidental part of the banking business. As more fully discussed in Note 5 of the notes to the accompanying unaudited condensed

consolidated financial statements in Item 1 of this Quarterly Report Form 10-Q, an allowance for loan losses has been established by management in order to provide for those loans, which for a variety of reasons, may not be repaid in their entirety. The allowance is maintained at a level considered by management to be adequate to provide for probable losses during the holding period of the loan and is based on methodologies applied on a consistent basis with the prior year. Management s review of the adequacy of the allowance includes, among other things, loan growth, changes in the composition of the loan portfolio, an analysis of past loan loss experience and management s evaluation of the loan portfolio under current and expected economic conditions.

The allowance for loan losses is based on estimates, and ultimate losses will vary from current estimates. The Bank recognizes that credit losses will be experienced and the risk of loss will vary with, among other things: general economic conditions; the type of loan being made; the creditworthiness of the borrower over the term of the loan; and, in the case of a collateralized loan, the quality and retention of value of the collateral for such loan. The allowance for loan losses represents the Bank s best estimate of the allowance necessary to provide for probable losses in the portfolio as of the balance sheet date.

If management determines that it is necessary to increase the allowance for loan losses, a provision for loan losses is taken from current income and assigned to the allowance. For the nine-month period ended September 30, 2013, the Bank s provision for loan losses was $1.2 million, a decrease of $1.7 million, or 59%, from the corresponding period of 2012. Management believes that the provision for loan losses was sufficient to provide for the risk of loss inherent with the increase in the average loan portfolio by $111.7 million, from $742.0 million for the nine months ended September 30, 2012, to $853.7 million for the nine months ended September 30, 2013, based upon the improvement in the quality of our loan portfolio specifically related to a substantial decrease in loans classified as substandard, an improvement in delinquency rates and a reduction in net charge-offs. By comparison, we recorded net loan charge-offs of $1.4 million for the nine month period ended September 30, 2013, and the allowance for loan losses at September 30, 2013, stood at $12.0 million, which was 1.40% of total gross loans outstanding as of the balance sheet date. See Analysis of Allowance for Loan Losses in the Financial Condition Section of Management s Discussion and Analysis of Financial Condition and Results of Operations.

Non-Interest Income

The table below represents the major components of non-interest income and the changes therein for the three- and nine-month periods ended September 30, 2013, as compared to the same periods in 2012.

	Three months ended September 30,				Nine months ended September 30,			
(dollars in thousands)	2013 amount	2012 amount	Amount change	Percent change	2013 amount	2012 amount	Amount change	Percent change
Service charges and fees	$ 1,109	$ 985	$ 124	12.59%	$ 3,354	$ 3,033	$ 321	10.58%
Investment securities gains, net	56	243	(187)	(76.95)%	506	423	83	19.62%
Gain on sale of assets	0	0	0	0.00%	0	0	0	0.00%
Income from merchant services	457	413	44	10.65%	1,424	1,506	(82)	(5.44)%
Income from cardholders	147	191	(44)	(23.04)%	832	977	(145)	(14.84)%
Wire transfer fees	167	167	0	0.00%	503	499	4	0.80%
Trustee fees	165	196	(31)	(15.82)%	429	533	(104)	(19.51)%
Other income	473	515	(42)	(8.16)%	1,540	1,591	(51)	(3.21)%
Total non-interest income	$ 2,574	$ 2,710	$ (136)	(5.02)%	$ 8,588	$ 8,562	$ 26	0.30%

For the three months ended September 30, 2013, non-interest income totaled $2.6 million, which represented a decrease of $136 thousand as compared to the same period in 2012. The decrease is attributed to the $187 thousand decrease in our net investment securities gains, primarily due to fewer opportunities to extract gains in the conversion of investment securities into loans, and reductions in trustee fees and other income. These decreases were partially offset by a $124 thousand increase in service charges and fees.

For the nine months ended September 30, 2013, there was a $26 thousand increase in total non-interest income from the same period in 2012 that was primarily due to a $321 thousand increase in service charges and fees, and the $83 thousand increase in our net investment securities gains. The increase in our net investment securities gains was the result of gains on the sale of securities to replenish the Bank s overnight liquidity and to take advantage of opportunities to restructure certain investment securities in order to reduce the weighted average life and duration so as to mitigate potential extension risk as interest rates rise. The increase in service charges and fees was caused by a rise in service fees on loans sold to FHLMC and commissions on the sale of insurance. These increases were partially offset by a $145 thousand decrease in income from cardholders and a $104 thousand decrease in trustee fees.

Non-interest Expense

The table below represents the major components of non-interest expense and the changes for the three- and nine-month periods ended September 30, 2013 and 2012.

	Three months ended September 30,				Nine months ended September 30,			
(dollars in thousands)	2013 amount	2012 amount	Amount change	Percent change	2013 amount	2012 amount	Amount change	Percent change
Salaries and employee benefits	$ 6,672	$ 6,233	$ 439	7.04%	$ 19,069	$ 18,336	$ 733	4.00%

Occupancy	1,785	1,567	218	13.91%	5,158	4,654	504	10.83%
Furniture and equipment	1,489	1,751	(262)	(14.96)%	4,510	4,552	(42)	(0.92)%
Insurance	420	442	(22)	(4.98)%	1,258	1,313	(55)	(4.19)%
Telecommunications	362	403	(41)	(10.17)%	1,099	1,153	(54)	(4.68)%
FDIC insurance expense	283	266	17	6.39%	834	751	83	11.05%
Contract services	288	216	72	33.33%	998	1,063	(65)	(6.11)%
Stationery & supplies	202	202	0	0.00%	584	682	(98)	(14.37)%
Professional services	379	492	(113)	(22.97)%	1,047	1,084	(37)	(3.41)%
Education	139	151	(12)	(7.95)%	554	377	177	46.95%
Other general operating expense	1,503	1,543	(40)	(2.59)%	5,747	5,181	566	10.92%
Total non-interest expense	$ 13,522	$ 13,266	$ 256	1.93%	$ 40,858	$ 39,146	$ 1,712	4.37%

For the three months ended September 30, 2013, non-interest expense totaled $13.5 million, which represented a $256 thousand increase as compared to the same period in 2012. The $256 thousand increase is largely attributed to the $439 thousand increase in salaries and employee benefits expense, and the $218 thousand increase in occupancy expense. The $439 thousand increase in salaries and employee benefits expense was the result of an annual merit increase in salaries for employees implemented during the second quarter of 2013, which is expected to be recurring. The increase in occupancy expense was primarily due to an increase in depreciation on our headquarters building and higher utilities expenses. These increases were partially offset by lower furniture and equipment expenses associated with a reduction in computer maintenance costs, and by a reduction in special professional services expenses due primarily to lower internal and external audit fees.

During the nine months ended September 30, 2013, total non-interest expense increased by $1.7 million from the year-earlier period. Forty-three percent of this increase was due to the $733 thousand increase in salaries and employee benefits expenses, which resulted from annual merit pay increases and a modest increase in staffing. The second largest increase, $566 thousand in other general operating expenses, constituted 33.1% of the overall increase in total non-interest expenses, and was the result of higher costs associated with other real estate owned. This increase was followed by $504 thousand in additional occupancy expenses, at 29.4%, caused by higher utilities costs and depreciation on the Bank s headquarters building. Education expenses increased by $177 thousand, or 10.3% of the total increase in non-interest expenses during the first nine months of 2013 as compared to the year-earlier period, as the result of enhancements to on-line training resources and tuition reimbursements. The remaining increase and the partially offsetting decreases in other expense categories are not considered to be material in understanding our financial statements.

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Income Tax Expense

For the three months ended September 30, 2013, the Bank recorded income tax expenses of $1.0 million. This compares to the $710 thousand in income tax expenses recorded for the corresponding period in 2012, and is the result of the increase of $661 thousand in net income before taxes as compared to the same period in 2012. For the nine months ended September 30, 2013, income tax expenses of $3.1 million were $510 thousand higher than the $2.6 million paid in the first three quarters of 2012 because of a corresponding increase in taxable income.

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Financial Condition

Assets

As of September 30, 2013, total assets were $1.42 billion, an increase of $203.9 million, or 16.8%, from $1.21 billion at December 31, 2012. This increase is largely attributed to the $218.8 million increase in our interest earning assets portfolio, led by the increase of $189.5 million in interest-earning deposits with other financial institutions, and was largely offset by a decrease of $14.6 million in cash and payments due from other banks. Much of this increase in deposits is related to the proceeds of a bond issues held in trust as deposits with the Bank and awaiting investment instructions, along with funds liquidated from a public retirement fund and deposited in the Bank while awaiting disbursement; the remaining portion of the increase is related to liquidity needs in the normal course of business. Our net loan portfolio increased by $96.8 million, primarily due to several commercial loans being funded in Guam and in San Francisco. We also had an increase of $33.3 million in investment securities held to maturity, partially as the result of the transfer of several securities from the available for sale classification in order to limit the impact of unrealized losses on other comprehensive income, an element of total equity. These increases were partially offset by a reduction of $100.7 million in investment securities available for sale, part of which was used to fund the increase in loans and part which was in the aforementioned transfer to securities held to maturity.

Interest-Earning Assets

The following table sets forth the composition of our interest-earning assets at September 30, 2013, as compared to December 31, 2012:

(dollars in thousands)	September 30, 2013	December 31, 2012	Variance
Interest-earning deposits with financial institutions	$ 222,277	$ 32,764	$ 189,513
Federal Funds sold	5,000	5,000	0
Federal Home Loan Bank stock, at cost	2,101	2,159	(58)
Investment securities available for sale	172,834	273,522	(100,688)
Investment securities held to maturity	91,460	58,125	33,335
Loans (net of allowances of $11,995 and $12,228 and deferred fees of $2,239 and $1,885)	845,612	748,832	96,780
Total interest-earning assets	$ 1,339,284	$ 1,120,402	$ 218,882

Loans

Commercial & industrial loans are loans to businesses to finance capital purchases and improvements, or to provide cash flow for operations. Commercial mortgage loans include loans secured by real property for purposes such as the purchase or improvement of that property, wherein repayment is derived from the income generated by the real property or from business operations. Residential mortgage loans are loans to finance the purchase, improvement, or refinancing of real property secured by 1-4 unit family residential housing. Consumer loans are loans to individuals for financing personal needs, and are either closed- or open-ended loans. Automobile loans and credit cards fall under the consumer loans category. The bulk of the other consumer loans are typically unsecured extensions of credit.

A summary of the balances of loans at September 30, 2013, and December 31, 2012, follows:

(dollars in thousands)	September 30, 2013 Amount	Percent	December 31, 2012 Amount	Percent
Commercial				
Commercial & industrial	$ 180,554	21.00%	$ 138,951	18.2%
Commercial mortgage	376,606	43.80%	314,462	41.2%
Commercial construction	758	0.09%	3,908	0.5%
Total commercial	557,918	64.89%	457,321	59.9%
Consumer				
Residential mortgage	157,187	18.28%	164,774	21.6%
Home equity	1,113	0.13%	1,211	0.2%
Automobile	7,556	0.88%	8,227	1.1%
Other consumer loans [1]	136,072	15.82%	131,412	17.2%
Total consumer	301,928	35.11%	305,624	40.1%
Gross loans	859,846	100.00%	762,945	100.0%
Deferred fee (income) costs, net	(2,239)		(1,885)	
Allowance for loan losses	(11,995)		(12,228)	
Loans, net	$ 845,612		$ 748,832	

[1] Comprised of other revolving credit, installment loans, and overdrafts.

At September 30, 2013, total gross loans increased by $96.9 million, or 12.7%, to $859.8 million from $762.9 million at December 31, 2012. The increase in loans was largely attributed to a $100.6 million increase in commercial loans to $557.9 million at September 30, 2013, from $457.3 million at December 31, 2012. This was due to several large loans originated in California and in Guam. By category, the increase in commercial

loans was due to a $62.1 million growth in the commercial mortgage portfolio, supplemented by a $41.6 million increase in commercial & industrial loans, which were partially offset by a $3.2 million decrease in commercial construction loans. The increase in commercial loans was partially offset by a $3.7 million decrease in consumer loans to $301.9 million at September 30, 2013, down from $305.6 million at December 31, 2012. The decrease in consumer loans was principally due to a $7.6 million reduction in residential mortgage loans as the result of principal paydowns, payoffs, and refinancing with the Federal Home Loan Mortgage Corporation in reaction to favorable interest rates, along with a $671 thousand reduction in automobile loans outstanding. These decreases were partially offset by an increase in other consumer loans, which include revolving credit, installment loans and overdrafts, by $4.7 million.

At September 30, 2013, loans outstanding were comprised of approximately 67.41% variable rate loans and 32.59% fixed rate loans.

Since it first opened in 1972, the Bank has expanded its operations and its branch network, first in Guam, then in the other islands of our region and in San Francisco, California. In the interests of enhancing performance and stability through market and industry diversification, the Bank has increased its focus on growth in the San Francisco area in recent years, adding personnel with experience and expertise in the Bay Area. The following table provides figures for loans in the Bank s administrative regions for the years ending December 31, 2010, 2011 and 2012, and the nine months ended September 30, 2013:

	At December 31,			At September 30,
	2010	2011	2012	2013
Guam	$ 459,641	$ 530,959	$ 498,728	$ 536,135
Commonwealth of the Northern Mariana Islands	$ 47,571	$ 71,190	$ 65,703	$ 61,036
The Freely Associated States of Micronesia *	$ 35,536	$ 38,742	$ 40,618	$ 40,764
California	$ 68,391	$ 87,307	$ 143,783	$ 207,677
Total	$ 611,139	$ 728,198	$ 748,832	$ 845,612

* The Freely Associated States are comprised of the Federated States of Micronesia (Chuuk, Kosrae, Pohnpei and Yap), the Republic of Palau and the Republic of the Marshall Islands.

As the table indicates, the Bank s total loans increased by 12.9% during the first nine months of 2013, and by a cumulative 22.5% in 2011 and 2012. By way of comparison, loans in the California region increased by 44.4% during the first nine months of 2013, and by a cumulative 110.2% in 2011 and 2012. While the Bank s overall loan portfolio continues to grow, more than half of that growth has been in the California region for the nine months ended September 30, 2013, and for the two years ended December 31, 2012, providing support for the expansion of the Bank.

Interest Earning Deposits and Investment Securities

In the current lending environment and in order to maintain sufficient liquidity in the ordinary course of business, the Bank maintained $221.9 million in interest earning deposits with financial institutions at September 30, 2013, an increase of $189.1 million or 576.52% from the $32.8 million in such deposits at December 31, 2012. This increase was primarily in our Federal Reserve account, and was principally comprised of deposits of $112.8 million from the proceeds of a municipal bond held in trust, awaiting investment instructions, and $27.3 million in deposits from a public retirement fund, awaiting disbursement, both of which are viewed as being temporary deposit balances. From

December 31, 2012, to September 30, 2013, the Bank s investment portfolio decreased by $67.4 million, or 20.3%, from $331.6 million to $264.3 million. The investment portfolio reduction was comprised of a $100.7 million decrease in available for sale securities, which declined by 36.8%, from $273.5 million to $172.8 million, partially offset by a $33.3 million increase in held to maturity securities, which increased by 57.4%, from $58.1 million to $91.5 million. Due to the increase in interest rates in the 2nd quarter of 2013, the Bank transferred ten securities from the available for sale classification to the held to maturity classification in August 2013 in order to freeze the unrealized loss on the securities. These reclassified securities had a collective face value of $48.7 million.

Non-Performing Loans and Other Non-Performing Assets

Non-performing loans consist of (i) loans on non-accrual status because we have ceased accruing interest on these loans; (ii) loans 90 days or more past due and still accruing interest; and, (iii) restructured loans. Other non-performing assets consist of real estate properties (OREO) that have been acquired through foreclosure or similar means and which management intends to offer for sale. Loans are placed on non-accrual status when, in the opinion of management, the full and timely collection of principal or interest is in doubt. Generally, the accrual of interest is discontinued when principal or interest payment becomes 90 days past due, unless the loan is adequately collateralized and the loan is in the process of collection. When a loan is placed in non-accrual status, accrued but unpaid interest is reversed against current income. Subsequently, when payments are received on such loans, the amounts are applied to reduce principal, except when the ultimate collectability of principal is probable, in which case accrued loans may be restored to accrual status when principal and interest becomes current and full repayment is expected. Interest income is recognized on an accrual basis for impaired loans not meeting the non-accrual criteria.

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The following table contains information regarding our non-performing assets as well as restructured loans as of September 30, 2013, and December 31, 2012.

(dollars in thousands)	September 30, 2013		December 31, 2012	
Non-accrual loans:				
Commercial & industrial	$	319	$	685
Commercial mortgage		6,379		7,977
Commercial construction		0		0
Residential mortgage		6,229		7,166
Home equity		64		76
Automobile		0		0
Other consumer		226		234
Total nonaccrual loans:	$	13,217	$	16,138
Loans past due 90 days and still accruing:				
Commercial & industrial	$	146	$	0
Commercial mortgage		0		0
Commercial construction		0		0
Residential mortgage		13		1,462
Home equity		0		0
Automobile		0		0
Other consumer		782		1,016
Total loans past due 90 days and still accruing	$	941	$	2,478
Total non-performing loans		14,158		18,616
Other real estate owned (OREO):				
Commercial real estate	$	2,923	$	3,881
Residential real estate		1,652		646
Total other real estate owned	$	4,575	$	4,527
Other non-performing assets:				
Other assets owned	$	0	$	0
Asset backed security		0		0
Total other nonperforming assets		0		0
Total nonperforming assets	$	18,733	$	23,143
Restructured loans:				
Accruing loans	$	3,625	$	705
Non-accruing loans (included in nonaccrual loans above)		5,676		5,970
Total restructured loans	$	9,301	$	6,675

The above table indicates that non-performing loans decreased by $4.5 million during the nine months ended September 30, 2013, which resulted primarily from the decrease in nonaccrual loans by $2.9 million to $13.2 million, down from $16.1 million at December 31, 2012. This decrease is largely attributed to the $1.6 million decrease in nonaccruing commercial mortgages and the reduction of $937 thousand in nonaccruing residential mortgages. In addition, loans 90 days past due and still accruing decreased by $1.5 million to $941 thousand at September 30, 2013, down from $2.5 million at December 31, 2012.

At September 30, 2013, the Bank s largest non-performing loans consist of two commercial loan relationships in the amount of $5.1 million, located in Guam. The two loan relationships are secured by real estate. The Guam loans were placed on non-accrual due to deficiencies in their cash flow to service the monthly loan payments and meet operating expenses. At this time, management believes that the allowance for loan losses is adequate to cover these loans; however, should property values deteriorate further, additional write-down or additional provisions may be necessary.

Analysis of Allowance for Loan Losses

The allowance for loans losses was $12.0 million, 1.40% of outstanding gross loans, as of September 30, 2013, as compared to $12.2 million or 1.60% of outstanding gross loans at December 31, 2012. This reduction in the amount and the ratio of the allowance was justified by an improvement of the quality of our loan portfolio.

Management maintains an allowance for loan losses to absorb estimated credit losses associated with the loan portfolio. The adequacy of the allowance is determined by management through ongoing quarterly loan quality assessments.

Management assesses the estimated credit losses inherent in the non-classified and classified portions of our loan portfolio by considering a number of factors or elements including:

- Management s evaluation of the collectability of the loan portfolio;

- Credit concentrations;

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- Historical loss experience in the loan portfolio;

- Levels of and trending in delinquency, classified assets, non performing and impaired loans;

- Effects of changes in underwriting standards and other changes in lending policies, procedures and practices;

- Experience, ability, and depth of lending management and other relevant staff;

- Local, regional, and national trends and conditions including industry-specific conditions;

- Effect of changes in credit concentration; and

- External factors such as competition, legal and regulatory conditions, as well as typhoon and other natural disasters.

Management calculates the allowance for the classified loan portfolio, non-classified loans and a homogeneous pool of loans based on an appropriate percentage loss factor that is calculated based on the above noted factors and trends. Management normally writes down impaired loans after determining the loans credit and collateral fair value. Our analysis of the adequacy of the allowance incorporates the provisions made for our non-classified loans, classified loans, and homogeneous pool of loans.

While management believes it uses the best information available for calculating the allowance, the results of operations could be significantly affected if circumstances differ substantially from the assumptions used in determining the allowance. The current qualitative and quantitative factors used to calculate the allowance are inherently subjective. The estimates and assumptions are subject to changes in economic and regulatory guidelines, and other circumstances over which management has no control. The allowance may prove in the future to be insufficient to cover all of the losses the Bank may incur and it may be necessary to increase the allowance from time to time as a result of monitoring the adequacy of the allowance for loan losses.

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The following table summarizes the changes in our allowance for loan losses.

(dollars in thousands)	Commercial	Residential Mortgages	Consumer Other	Total
Nine months Ended September 30, 2013				
Allowance for loan losses:				
Balance at beginning of period	$ 6,251	$ 1,453	$ 4,524	$ 12,228
Charge offs	(95)	(164)	(2,543)	(2,802)
Recoveries	61	138	1,175	1,374
Provision	(849)	(302)	2,346	1,195
Balance at end of period	$ 5,368	$ 1,125	$ 5,502	$ 11,995
Three Months Ended September 30, 2013				
Allowance for loan losses:				
Balance at beginning of quarter	$ 5,449	$ 1,066	$ 5,160	$ 11,675
Charge offs	(25)	(134)	(914)	(1,073)
Recoveries	8	135	350	493
Provision	(64)	58	906	900
Balance at end of quarter	$ 5,368	$ 1,125	$ 5,502	$ 11,995
Allowance balance at September 30, 2013, related to:				
Loans individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0
Loans collectively evaluated for impairment	$ 5,368	$ 1,125	$ 5,502	$ 11,995
Loan balances at September 30, 2013:				
Loans individually evaluated for impairment	10,323	6,293	226	16,842
Loans collectively evaluated for impairment	547,595	152,007	143,402	843,004
Total	$ 557,918	$ 158,300	$ 143,628	$ 859,846
At December 31, 2012				
Allowance for loan losses:				
Loans individually evaluated for impairment	$ 0	$ 0	$ 0	$ 0
Loans collectively evaluated for impairment	$ 6,251	$ 1,453	$ 4,524	$ 12,228
Loan balances at December 31, 2012:				
Loans individually evaluated for impairment	$ 9,367	$ 7,242	$ 234	$ 16,843
Loans collectively evaluated for impairment	447,954	158,743	139,405	746,102
Total	$ 457,321	$ 165,985	$ 139,639	$ 762,945

Total Cash and Cash Equivalents

Total cash and cash equivalents were $248.8 million and $74.2 million at September 30, 2013, and December 31, 2012, respectively, an increase of $174.6 million, or 235.4%. This balance, which is comprised of cash and due from bank balances, federal funds sold and unrestricted interest-bearing deposits that we maintain at other financial institutions (including the Federal Reserve Bank of San Francisco) will vary depending on daily cash settlement activities, the amount of highly liquid assets needed based on known events such as anticipated or scheduled withdrawals from customer depository accounts, the repayment of borrowings and funding of loans, and actual cash on hand in the Bank s branches. The increase in the balance during the period was primarily due to an increase of $211.8 million in total deposits, which was partially offset by the payoff of $10.0 million in Federal Home Loan Bank borrowings and the payoff of promissory notes of $145 thousand. The increase in deposits and the payoff of borrowings were supplemented by a decrease of $67.4 million in investment securities. The increase in total deposits was primarily due to the deposit of bond funds held in trust and awaiting investment instructions, along with funds liquidated from a public retirement fund s investments and awaiting disbursement.

The following table sets forth the composition of our cash and cash equivalent balances at September 30, 2013, and December 31, 2012:

(dollars in thousands)	September 30, 2013	December 31, 2012	Variance to December 31
Cash and due from banks	$ 21,960	$ 36,575	$ (14,615)
Federal funds sold	5,000	5,000	0
Interest-bearing deposits with financial institutions	221,877	32,614	189,263
Total cash and cash equivalents	$ 248,837	$ 74,189	$ 174,648

Investment Securities

The subsidiary Bank manages its securities portfolio to provide a source of both liquidity and earnings. The Bank has an Asset/Liability Committee (ALCO) that develops current investment policies based on the Bank s operating needs and market circumstances. The Bank s investment policy is formally reviewed and approved annually by the Board of Directors, and the Asset/Liability Committee is responsible for reporting and monitoring compliance with the investment policy. Investment portfolio reports are provided to the Board of Directors on a monthly basis, two inside Board members sit on the Committee, and an additional inside Board member attends the meeting along with three outside Board members quarterly.

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At September 30, 2013, the carrying value of the investment securities portfolio totaled $264.3 million, which represents a $67.4 million decrease from the portfolio balance of $331.6 million at December 31, 2012. The table below sets forth the composition of our investment securities portfolio at September 30, 2013, and December 31, 2012:

The amortized cost and fair value of investment securities, with gross unrealized gains and losses, follows:

	September 30, 2013			
	Amortized Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Securities Available for Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 8,420	$ 0	$ 52	$ 8,472
U.S. government agency pool securities	56,270	(480)	130	55,920
U.S. government agency or GSE mortgage-backed securities	109,128	(1,126)	440	108,442
	$ 173,818	$ (1,606)	$ 622	$ 172,834
Securities Held to Maturity				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 32,687	$ 0	$ 437	$ 33,124
U.S. government agency pool securities	1,800	(9)	37	1,828
U.S. government agency or GSE mortgage-backed securities	56,973	(350)	1,153	57,776
	$ 91,460	$ (359)	$ 1,627	$ 92,728

	December 31, 2012			
	Amortized Cost	Gross Unrealized Losses	Gross Unrealized Gains	Fair Value
Securities Available for Sale				
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 59,923	$ (138)	$ 360	$ 60,145
U.S. government agency pool securities	73,663	(140)	275	73,798
U.S. government agency or GSE mortgage-backed securities	137,282	(152)	2,449	139,579
	$ 270,868	$ (430)	$ 3,084	$ 273,522
Securities Held to Maturity				
U.S. government agency pool securities	$ 1,966	$ (3)	$ 45	$ 2,008
U.S. government agency or GSE mortgage-backed securities	56,159	0	2,054	58,213

	$ 58,125	$ (3)	$ 2,099	$ 60,221

At September 30, 2013, and December 31, 2012, investment securities with a carrying value of $199.6 million and $142.3 million, respectively, were pledged to secure various government deposits and other public requirements.

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The amortized cost and fair value of investment securities by contractual maturity at September 30, 2013, and December 31, 2012, follows:

	September 30, 2013			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due after one but within five years	$ 0	$ 0	$ 0	$ 0
Due after five years	8,420	8,472	32,687	33,124
U.S. Government agency pool securities	56,270	55,920	1,800	1,828
Mortgage-backed securities	109,128	108,442	56,973	57,776
Total	$ 173,818	$ 172,834	$ 91,460	$ 92,728

	December 31, 2012			
	Available for Sale		Held to Maturity	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due after one but within five years	$ 4,997	$ 5,035	$ 0	$ 0
Due after five years	54,926	55,110	0	0
U.S. Government agency pool securities	73,663	73,798	1,966	2,008
Mortgage-backed securities	137,282	139,579	56,159	58,213
Total	$ 270,868	$ 273,522	$ 58,125	$ 60,221

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Temporarily Impaired Securities

The following table shows the gross unrealized losses and fair value of investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and the length of time that individual securities have been in a continuous unrealized loss position at September 30, 2013, and December 31, 2012.

	September 30, 2013					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
Securities Available for Sale						
U.S. government agency and sponsored enterprise (GSE) debt securities	$ 0	$ 0	$ 0	$ 0	$ 0	$ 0
U.S. government agency pool securities	(480)	48,128	0	0	(480)	48,128
U.S. government agency or GSE mortgage-backed securities	(1,126)	70,369	0	0	(1,126)	70,369
Total	$ (1,606)	$ 118,497	$ 0	$ 0	$ (1,606)	$ 118,497
Securities Held to Maturity						
U.S. government agency pool securities	$ (4)	$ 143	$ (5)	$ 288	$ (9)	$ 431
U.S. government agency or GSE mortgage-backed securities	(350)	19,544	0	0	(350)	19,544
Total	$ (354)	$ 19,687	$ (5)	$ 288	$ (359)	$ 19,975

	December 31, 2012					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value	Unrealized Loss	Fair Value
Securities Available for Sale						
U.S. government agency and sponsored enterprise (GSE) debt securities	$ (138)	$ 29,836	$ 0	$ 0	$ (138)	$ 29,836
U.S. government agency pool securities	(139)	29,921	(1)	76	(140)	29,997
U.S. government agency or GSE mortgage-backed securities	(136)	25,420	(16)	3,216	(152)	28,636
	$ (413)	$ 85,177	$ (17)	$ 3,292	$ (430)	$ 88,469
Securities Held to Maturity						
U.S. government agency pool securities	$ 0	$ 29	$ (3)	$ 302	$ (3)	$ 331
U.S. government agency or GSE mortgage-backed securities	0	0	0	0	0	0

	$ 0	$ 29	$ (3)	$ 302	$ (3)	$ 331

The Company does not believe that any of the investment securities that were in an unrealized loss position as of September 30, 2013, which comprised a total of 38 securities, were other-than-temporarily impaired. Specifically, the 38 securities are comprised of the following: 15 Small Business Administration (SBA) Pool securities, 3 mortgage-backed securities issued by the Federal Home Loan Mortgage Corporation (FHLMC), 15 mortgage-backed securities issued by the Government National Mortgage Association (GNMA), and 5 mortgage-backed securities issued by the Federal National Mortgage Association (FNMA). It is anticipated that these securities will be repaid at their full par value upon maturity.

Total gross unrealized losses were primarily attributable to changes in interest rates, relative to when the investment securities were purchased, and not due to changes in the credit quality of the investment securities. The Company does not intend to sell the investment securities that were in an unrealized loss position and it is not likely that the Company will be required to sell the investment securities before recovery of their amortized cost bases, which may be at maturity.

Deposits

At September 30, 2013, total deposits increased by $211.8 million to $1.31 billion as compared to $1.10 billion in total deposits at December 31, 2012. Interest-bearing deposits increased by $182.7 million to $1.01 billion at September 30, 2013, up from $823.2 million at December 31, 2012, while non-interest bearing deposits increased by $29.0 million to $308.4 million at September 30, 2013, up from $279.3 million at December 31, 2012. The 19.2% increase in total deposits was primarily due to the temporary deposit of $112.8 million in bond proceeds held in trust and awaiting investment instructions and the temporary deposit of $27.3 million in public retirement funds from liquidated investments awaiting disbursement, along with a gradual recovery of the economies of Guam and the Northern Mariana Islands, the latter of which was reflected primarily in Commonwealth government deposits. There was also an increase of $15.4 million in government and private deposits in the Freely Associated States (FAS) of the Federated States of Micronesia, the Republic of the Marshall Islands and the Republic of Palau, and growth in our San Francisco market by $8.5 million. The deposit increases in the FAS were concentrated in the RMI and the FSM, and were primarily associated with the increase of business and government deposits, supplemented by smaller increases in consumer deposits, and partially offset by a reduction in business deposits in the ROP.

The following table sets forth the composition of our interest-bearing deposit portfolio with the average balances and average interest rates for the nine months ending September 30, 2013, and September 30, 2012, respectively:

	Nine months ending			
	September 30, 2013		September 30, 2012	
(dollars in thousands)	Average balance	Average rate	Average balance	Average rate
Interest-bearing deposits:				
Interest-bearing checking accounts	$ 119,532	0.15%	$ 101,976	0.24%
Money market and savings accounts	710,681	0.61%	657,248	0.70%
Certificates of deposit	55,236	0.41%	58,477	0.37%
Total interest-bearing deposits	$ 885,449	0.54%	817,701	0.47%

As mentioned earlier, the Bank has expanded its operations and its branch network since it first opened in 1972, first in Guam, then in the other islands of our region and in San Francisco, California. As time has passed and the Bank has gathered market share in each of the islands. In recent years, in order to diversify its geographic market, the Bank has increased its focus on growth in the San Francisco area. The following table provides figures for deposits in the Bank s administrative regions for the years ending December 31, 2010, 2011 and 2012, and at September 30, 2013:

	At December 31,			At September 30,
	2010	2011	2012	2013
Guam	$ 520,060	$ 629,206	$ 640,893	$ 780,863
Commonwealth of the Northern Mariana Islands	$ 153,882	$ 161,918	$ 180,220	$ 228,111
The Freely Associated States of Micronesia *	$ 182,281	$ 193,485	$ 212,722	$ 228,097
California	$ 33,052	$ 53,730	$ 68,705	$ 77,252

Total	$ 889,275	$ 1,038,339	$ 1,102,540	$ 1,314,323

* The Freely Associated States are comprised of the Federated States of Micronesia (Chuuk, Kosrae, Pohnpei and Yap), the Republic of Palau and the Republic of the Marshall Islands.

During the first nine months of 2013, deposits increased by a total of $211.8 million, of which $140.0 million, or 66.1%, was in the Bank s Guam branches. Deposits increased in our CNMI branches by $47.9 million and increased in our Freely Associated States branches by $15.4 million. Overall, the Bank s deposit base increased by 19.2% during the first nine months of 2013, and by 24.0% from December 31, 2010 to December 31, 2012. In comparison, deposits grew in the California region by 12.4% in the nine months ended September 30, 2013, and by a cumulative 107.9% during 2011 and 2012. The California region accounted for 4.0% of total Bank deposit growth during the first nine months of this year, and 16.7% of total deposit growth from December 31, 2010 to December 31, 2012. Again, the continuing growth of the California region s deposit base has substantially supplemented the growth of the other administrative regions and of the whole Bank.

Borrowed Funds

The Bank has a variety of sources from which it may obtain secondary funding. These sources include, among others, the Federal Reserve Bank of San Francisco, the Federal Home Loan Bank-Seattle, and credit lines established with our correspondent banks. Borrowings are obtained for a variety of reasons which include, but are not limited to, funding loan growth, the purchase of investments in the absence of core deposits, and to provide additional liquidity to meet the demands of depositors.

At September 30, 2013, the Bank had no short-term borrowings, a decrease of 100% from $10.145 million at December 31, 2012. This was due to the payoff of a $10.0 million borrowing from the Federal Home Loan Bank-Seattle and a short-term borrowings payoff of $145 thousand.

Liquidity

We actively manage our liquidity to ensure that sufficient funds are available to meet our needs for cash, including cash needed to fund new loans and to accommodate deposit withdrawals by our customers. We project future sources and uses of funds, and maintain additional liquid funds for unanticipated events. Our primary sources of cash include cash we have in deposits at other financial institutions, the repayment of loans, proceeds from the sale or maturity of investment securities, and increases in deposits. The primary uses of cash include funding new loans and making advances on existing lines of credit, purchasing investments, funding new residential mortgage loans, funding deposit withdrawals, and paying operating expenses. We maintain funds in overnight Federal Funds and other short-term investments to provide for short-term liquidity needs. We also have established, for contingency funding purposes, credit lines with the Federal Reserve Bank of San Francisco, the Federal Home Loan Bank-Seattle, and correspondent commercial banks in the U.S.

At September 30, 2013, our liquid assets, which include cash and due from banks, federal funds sold, unrestricted interest-earning deposits with financial institutions, and investment securities available for sale, totaled $421.7 million, up $74.0 million from $347.7 million at December 31, 2012. This increase is comprised of the rise of $174.6 million in total cash and cash equivalents, offset by the $100.7 million decrease in investment securities available for sale. The increase in cash and cash equivalents was the result of an increase of $189.3 million in interest bearing deposits in banks, offset by the $14.6 million decrease in cash and funds due from other banks. The level of liquidity at September 30, 2013, was deemed to be adequate to meet the Bank s needs even under the most severe conditions, as analyzed quarterly by stress testing as a part of the Asset and Liability Committee s duties.

Contractual Obligations

The Bank utilizes facilities, equipment and land under various operating leases with terms, including renewal options, ranging from 1 to 99 years. Some of these leases include scheduled rent increases. The total amount of the rent is being debited to expense on the straight-line method over the lease terms in accordance with ASC Topic 840 *Leases* . The Bank has recorded a deferred obligation of $745 thousand and $698 thousand as of September 30, 2013, and December 31, 2012, respectively, which has been included within other liabilities to reflect the excess of rent expense over cash paid on the leases.

At September 30, 2013, future lease commitments under the above non-cancelable operating leases were as follows:

Periods ending December 31,		*(dollars in thousands)*
2013	$	1,985
2014		1,379
2015		1,072
2016		886
Thereafter		19,709
Total	$	25,289

The Bank leases certain facilities from two separate entities in which two of its directors have separate ownership interests. Lease payments made to these entities during the nine months ended September 30, 2013, and the twelve months ended December 31, 2012, approximated $278 thousand and $358 thousand, respectively.

Additionally, the Bank leases office space to third parties, with original lease terms ranging from 3 to 5 years with option periods ranging up to 15 years. At September 30, 2013, minimum future rents to be received under non-cancelable operating sublease agreements were $267, $54, $40, and $27 thousand for the periods ending December 2013, 2014, 2015, and 2016, respectively.

A summary of rental activities for the nine-month periods ended September 30, 2013 and 2012, is as follows:

(dollars in thousands)	September 30, 2013	September 30, 2012
Rental expense	$ 1,748	$ 1,708
Less: sublease rentals	200	190
Net rental expense	$ 1,548	$ 1,518

Off-Balance-Sheet Arrangements

The Bank is a party to credit related financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers. These financial instruments include commitments to extend credit, standby letters of credit and commercial letters of credit. Such commitments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount reflected in the consolidated financial statements.

The Bank s exposure to credit loss, in the event of nonperformance by the other parties to financial instruments for loan commitments and letters of credit, is represented by the contractual amount of these instruments. The Bank follows essentially the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments.

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A summary of financial instruments with off-balance-sheet risk at September 30, 2013, and December 31, 2012, is as follows:

(dollars in thousands)	September 30, 2013	December 31, 2012
Commitments to extend credit	$ 108,988	$ 100,007
Letters of credit:		
Standby letters of credit	$ 47,554	$ 26,178
Other letters of credit	2,342	3,030
Total letters of credit	$ 49,896	$ 29,208

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses, and may require payment of a fee. The commitments for certain lines of credit may expire without being drawn upon. Therefore, the total commitment amounts do not necessarily represent future cash requirements. The Bank evaluates each customer s creditworthiness on a case-by-case basis. The amount of collateral obtained, if it is deemed necessary by the Bank upon the extension of credit, is based on management s credit evaluation of the customer.

Commercial and standby letters of credit are conditional commitments issued by the Bank to guarantee the performance of a customer to a third party or the shipment of merchandise from a third party. Those letters of credit are primarily issued to support public and private borrowing arrangements. Almost all letters of credit issued have expiration dates within one year. The credit risk involved in issuing letters of credit is effectively the same as that involved in extending loan facilities to customers. The Bank generally holds collateral supporting those commitments.

The Bank considers its standby letters of credit to be guarantees. At September 30, 2013, the maximum undiscounted future payments that the Bank could be required to make was $49.9 million. All of these arrangements mature within one year. The Bank generally has recourse to recover from the customer any amounts paid under these guarantees. Most of the guarantees are fully collateralized; however, several that are extended to the Bank s most creditworthy customers are unsecured. The Bank had not recorded any liabilities associated with these guarantees at September 30, 2013.

Mortgage loans serviced for others are not included in the accompanying consolidated statements of condition. The unpaid principal balances of mortgage loans serviced for others were $204.6 million and $197.4 million at September 30, 2013, and December 31, 2012, respectively. On September 30, 2013, and December 31, 2012, the Bank recorded mortgage servicing rights at their fair value of $1.35 million and $1.29 million, respectively.

Capital Resources

The Bank is subject to various regulatory capital requirements administered by the United States federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Bank s consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of their assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices.

Quantitative measures established by regulation to ensure capital adequacy require the Bank to maintain minimum amounts and ratios (set forth in the following table) of total and Tier 1 capital (as defined in the regulations) to risk-weighted assets (as defined) and of Tier 1 capital (as defined) to average assets (as defined). Management believes that, as of September 30, 2013, and December 31, 2012, the Bank met all capital adequacy requirements to which it is subject.

As of September 30, 2013, the most recent notification from the Federal Deposit Insurance Corporation categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized, an institution must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the following table. There are no conditions or events since the FDIC notification that management believes have changed the Bank s category. The Bank s actual capital amounts and ratios as of September 30, 2013, and December 31, 2012, are also presented in the table.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	Ratio	Amount	Ratio	Amount	Ratio
At September 30, 2013:						
Total capital (to Risk Weighted Assets)	$ 106,514	12.53%	$ 67,995	8.00%	$ 84,994	10.00%
Tier 1 capital (to Risk Weighted Assets)	$ 96,011	11.44%	$ 33,577	4.00%	$ 50,366	6.00%
Tier 1 capital (to Average Assets)	$ 96,011	7.31%	$ 52,569	4.00%	$ 65,711	5.00%
At December 31, 2012:						
Total capital (to Risk Weighted Assets)	$ 101,489	13.51%	$ 60,094	8.00%	$ 75,118	10.00%
Tier 1 capital (to Risk Weighted Assets)	$ 92,206	12.43%	$ 29,676	4.00%	$ 44,514	6.00%
Tier 1 capital (to Average Assets)	$ 92,206	7.40%	$ 49,854	4.00%	$ 62,317	5.00%

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At September 30, 2013, our total stockholders equity was $93.0 million, a decrease of $1.4 million from the $94.4 million at December 31, 2012. In accordance with FASB 115, issued in 1993 by the Financial Accounting Standards Board, our portfolio of available for sale securities must be revalued at the end of each quarter to most accurately present our financial condition to stockholders and other interested parties. Any adjustment to the valuation is reflected as a component of equity, other comprehensive income. Due to changes in market interest rates, the revaluation of our portfolio caused a reduction of $5.5 million in the fair value of our available for sale securities, but this was partially offset by an increase of $4.0 million in our retained earnings after the payment of dividends in the amount of $3.3 million.

Contingency Planning and Cybersecurity

The services provided by banks are crucial to the continuing performance of the economy, so it is very important that banks are able to conduct business as usual on an ongoing basis. In light of this, the Bank has developed a comprehensive business continuity plan to address whatever disruptions may directly affect customers or change internal processes, whether caused by man-made or natural events. Training in the plan components is conducted annually, and risk-based testing of the major processes and procedures within the Bank occur on a regular basis. In modern banking, technology has taken on an increasingly important role, and the Bank also has a disaster recovery plan, incorporated into the business continuity plan, that provides specific, detailed procedures for recovering quickly from any technology failure. The disaster recovery plan procedures are actively tested, and are also implemented from time to time. The recovery time objectives for all major technological processes range from two hours to 16 hours, enabling the Bank to maintain or resume operations with a minimum impact on its customers. As the results of testing are analyzed and as technology continues to advance, improvements are made in the Bank s processes and procedures as the plans evolve.

The rapid advances in computing and telecommunications technology over the past several decades have brought with them increasingly sophisticated methods of delivering financial services through electronic channels. Along with these advances, though, have come risks regarding the integrity and privacy of data, and these risks apply to banking, perhaps more than any other industry, falling into the general classification of cybersecurity. The Bank has made substantial investments in multiple systems to ensure both the integrity of its data and the protection of the privacy of its customers personal financial and identity information. While it is not possible for anyone to give an absolute guarantee that data will not be compromised, the Bank is confident that its systems provide a reasonable assurance that the financial and personal data that it holds are secure.

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Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms, and that such information is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure. In designing and evaluating our disclosure controls and procedures, our management recognized that any system of controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, as ours are designed to do, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

As required by Rules 13a-15 and 15d-15 under the Exchange Act, in connection with the filing of this Quarterly Report on Form 10-Q, an evaluation was performed under the supervision and with the participation of our management, including our CEO and CFO, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2013. Based on the evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our internal control over financial reporting was effective as of September 30, 2013, and that the Company s disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in our reports filed under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s Rules and forms and is accumulated and communicated to management, including our Chief Executive and Chief Financial Officers, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting during the three months ended September 30, 2013, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II. OTHER INFORMATION

Item 6. Exhibits

Exhibit No.	Exhibit
31.01	Certification of Chief Executive Officer under Section 302 of the Sarbanes-Oxley At of 2002
31.02	Certification of Chief Financial Officer under Section 302 of the Sarbanes-Oxley Act of 2002
32.01	Certification of Chief Executive Officer and Chief Financial Officer under Section 906 of the Sarbanes-Oxley Act of 2002
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Unaudited Condensed Consolidated Statements of Condition as of September 30, 2013 and December 31, 2012, (ii) Unaudited Condensed Consolidated Statements of Income for the three and nine months ended September 30, 2013 and 2012, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Income for the three and nine months ended September 30, 2013 and 2012, (iv) Unaudited Condensed Consolidated Statements of Stockholders Equity as of September 30, 2013 and 2012, (v) Unaudited Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2013 and 2012 and (vi) Notes to Unaudited Condensed Consolidated Financial Statements

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SIGNATURES

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

	BANKGUAM HOLDING COMPANY
Date: November 8, 2013	By: /s/ LOURDES A. LEON GUERRERO Lourdes A. Leon Guerrero, President and Chief Executive Officer
Date: November 8, 2013	By: /s/ FRANCISCO M. ATALIG Francisco M. Atalig, Senior Vice President and Chief Financial Officer

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