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

FORM 10-K

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

For the fiscal year ended December 31, 2019

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

111 W Chalan Santo Papa
Hagåtña, Guam 96910
(671) 472-5300
(Address, including Zip Code, and telephone number, including area code, of the registrant's principal executive offices)

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

Title of Each Class	Trading Symbol(s)	Name of Each Exchange on which Registered
None	N/A	N/A

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

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

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ☒ No ☐

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

Large accelerated filer	☐	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☒
Emerging growth company	☐		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

The aggregate market value of the voting stock held by non-affiliates of the Registrant was $53,911,224 based on the number of shares held by non-affiliates of the registrant as of June 30, 2019, and based on the closing sale price of common stock on June 28, 2019, which is the last business day of the registrant's most recently completed second fiscal quarter. This calculation does not reflect a determination that persons are affiliates for any other purposes.

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Common Stock, $0.2083 par value per share	"BKGM"	Not listed

As of March 19, 2020, there were 9,674,156 shares outstanding.

BANKGUAM HOLDING COMPANY
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Cautionary Note Regarding Forward-Looking Statements

For purposes of this Annual Report, the terms the “Company,” “we,” “us” and “our” refer to BankGuam Holding Company and its subsidiaries. This Annual Report on Form 10-K 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 21E 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 (including the global coronavirus pandemic), 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 and fair value measurements;
- 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 change 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 effect of changes in accounting policies and practices, as may be adopted by the regulatory agencies, as well as the Public Company Accounting Oversight Board, the Financial Accounting Standards Board and other accounting standard setters;
- 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 safe 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 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 Annual 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 Quarterly Reports on Form 10-Q to be filed by us in our fiscal year ending December 31, 2019. 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 Annual 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 Annual Report.

PART I

ITEM 1. Business

General

BankGuam Holding Company (the “Company”), a Guam corporation organized in 2011, is a bank holding company registered under the Bank Holding Company Act of 1956, as amended. The Company provides a wide range of banking services through Bank of Guam, our wholly-owned subsidiary and principal asset (the “Bank”). Unless the context indicates otherwise, references to the “Company” include the Company’s subsidiaries, including the Bank. The Company, the Bank and their subsidiaries are sometimes referred to hereinafter as “we,” “our” or “us”.

The Bank is a regional community bank that was organized in Guam, a United States flag territory, in 1972. 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. We attract deposits throughout our market area with a customer-oriented product mix, competitive pricing and convenient locations. We lend in all markets where we have a physical presence through our branch network. The Bank also provides many other financial services to its customers, including trade financing and trust services.

In addition to the traditional financial services offered, the Bank offers credit life, health, auto and homeowners insurance through its subsidiary, BankGuam Insurance, as agents for various insurance companies. Through a second subsidiary, BankGuam Investment Services (“BGIS”), the Company offer options and opportunities of our customers to build future income and wealth. BGIS is a registered investment company, primarily involved in providing investment advisory services and trading securities for its customers.

In May 2016, the Company entered into a Stock Purchase Agreement (the “Agreement”) to acquire 25% of ASC Trust LLC, formerly ASC Trust Corporation. In July 2016, subsequent to the approval of the Federal Reserve Bank of San Francisco in June 2016, the purchase was executed. The Company borrowed $3.5 million in the form of subordinated debt in connection with the purchase to finance the transaction. On July 1, 2019, with the approval of the Federal Reserve Bank of San Francisco, the Company used $4.1 million of the proceeds from the subordinated notes totaling $15.0 million that were issued on June 27, 2019, to acquire an additional 20% ownership interest in ASC Trust LLC. This transaction brought the Company’s non-controlling interest in ASC Trust LLC to 45%. See “Note 22 – Subordinated Debt” for more detailed information on the subordinated notes. The Agreement provides for the acquisition of an additional 25% of the stock of ASC Trust LLC in April 2021, with the future purchase subject to regulatory approval. The Agreement contains customary warranties, representations and indemnification provisions. ASC Trust LLC is primarily involved in administering 401(k) retirement plans and other employee benefit programs for its customers.

Other than holding the shares of the Bank, BGIS and ASC Trust LLC, 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, 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 its assets are owned by the Bank, which accounts for substantially all of its consolidated revenues, expenses and operating income.

Bank of Guam

The Bank is a Guam-chartered bank headquartered at 111 West Chalan Santo Papa in Hagåtña, Guam 96910. It was incorporated in March 1972 and opened for business in December of that year. We operate through 22 full service branch offices, including 11 in Guam; two in Saipan and one each in Tinian and Rota, all in the Commonwealth of the Northern Mariana Islands; one in the Republic of Palau; one each in the states of Yap, Chuuk, Pohnpei and Kosrae in the Federated States of Micronesia; one in the Republic of the Marshall Islands; and one in San Francisco, California.

The Bank’s business strategy has been to emphasize and support economic growth and development in and among the U.S.-affiliated islands in the western Pacific Ocean. To accomplish this goal, the Bank offers competitively-priced deposit and loan products and other financial services that are primarily tailored to the needs of consumers, small businesses and government entities. Although the needs of our customers in a small, remote island environment can be particularly challenging for a community bank, we have succeeded in providing a broad range of services, such as trade financing and corporate trust services, that are typically provided only by much larger, money center institutions.

Our lending products include commercial, real estate, construction, consumer and Small Business Administration-guaranteed loans. We also provide home mortgage and home equity loans. Commercial loans and industrial loans comprise the largest portion of the Bank’s loan portfolio. Residential mortgage loans comprise the second largest portion of the Bank’s loan portfolio. At December 31, 2019, the Bank had a loan concentration in Commercial Real Estate loans for rentals and property development management purposes totaling $305.3 million, 23.4% of $1.31 billion in total loans outstanding.

We offer a wide range of deposit products for retail and business banking markets including checking accounts, interest-bearing transaction accounts, savings accounts, time deposits and retirement accounts. Our branch network enables us to attract deposits from throughout our market area with a customer-oriented product mix, competitive pricing and convenient locations. At December 31, 2019, the Bank had deposit concentrations in government savings and demand deposits totaling $291.3 million (16.8%) and $248.4 million (14.3%), respectively, of $1.73 billion in total deposits.

In addition, correspondent bank deposit accounts are maintained to enable the Bank to transact types of activity that it would otherwise be unable to perform or would not be cost effective due to the size of the Bank or the volume of activity. The Bank has utilized several correspondent banks to process a variety of transactions. The Bank also provides a multitude of other products and services to complement our lending and depository services. These include wire and Automated Clearing House transfers, cashier's checks, traveler's checks, corporate and consumer credit cards, bank-by-mail, ATMs, night depositories, safe deposit boxes, direct deposit, electronic funds transfers, online banking and bill payments, merchant services, check imaging, and other customary banking services. We currently operate ATMs in eighty-five locations.

The Bank has a trust department, primarily engaged in corporate trust services under indenture.

Competition

Banking and the financial services industry in Guam are highly competitive. The market is dominated by the Bank, two of Hawaii's largest banks and two locally-organized federal credit unions. Also, as a result of the U.S. military presence as a longtime employer, military credit unions have physical branches at the island's main military facilities and in the civilian community. The Bank's presence in the remaining areas of the western Pacific is less competitive, and in many cases the Bank remains the dominant financial services organization in the islands. In the San Francisco Bay area, where the Bank has had a branch office since 1983, the Bank's California division primarily focuses its lending efforts on owner-occupied commercial real estate and commercial investor properties. The division provides financing to hotels, gasoline service stations, apartments, office and retail space, and residential care homes for the elderly and disabled, and also works closely with selected banks in loan participations. Framing this environment is the increasingly competitive setting as a result of regulatory, technological and product delivery systems changes.

Larger banks have a competitive advantage because of global marketing campaigns and U.S. name recognition. They also offer extensive international trade finance and discount brokerage services that the Bank is not currently prepared to provide. To compensate for this, the Bank has arrangements with correspondent banks and other financial institutions to deliver such services to its customers.

To compete with other financial institutions in its service area, the Bank relies principally on local media as well as personal contact by directors, officers and employees with existing and potential customers. The Bank emphasizes to customers the advantages of dealing with a locally-owned and managed community-oriented institution. Because decisions are made locally by people who are intimately familiar with the economy, the legal structure and the developmental needs of the islands, the Bank is able to respond quickly and effectively to its customers' needs. The Bank also provides local service and timely decision-making for small businesses and local governments.

The financial services industry continues to undergo rapid technological changes involving the frequent introductions of new technology-driven products and services that have further increased competition. The Bank often adopts these new technologies and products ahead of its competitors, but there is no assurance that these technological improvements, if made, will increase the Company's operational efficiency, or that the Company will be able to effectively implement new technology-driven products and services or be successful in marketing these products and services to our customers.

Employees

At December 31, 2019, the Bank had 618 full-time equivalent employees (FTEs), a decrease from 623.5 FTEs a year earlier. The Bank's employees are not represented by any union or collective bargaining agreement, and the Bank believes its employee relations are good.

Supervision and Regulation

Recent Developments

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") of 2010 significantly changed the U.S. bank regulatory structure and affected the lending, deposit, investment, trading and operating activities of financial institutions and their holding companies. The Dodd-Frank Act required various federal agencies to adopt a broad range of new implementing rules and regulations, and to prepare numerous studies and reports for Congress. The federal agencies were given significant discretion in drafting the implementing rules and regulations. Although many of the final rules and regulations called for by the Dodd-Frank Act have been adopted, the implementation of some of those rules and regulations is in its early stages, and rulemaking has not yet become final for certain Dodd-Frank Act provisions. On May 24, 2018, the Economic Growth, Regulatory Relief, and Consumer Protection Act (the "EGRRCPA") amended provisions in the Dodd-Frank Act as well as certain other statutes administered by the federal bank agencies. We continue to monitor and implement rules and regulations of the Dodd-Frank Act and the EGRRCPA as they are adopted and modified, and to evaluate their application to our business.

Among other things, the Dodd-Frank Act required the federal banking agencies to establish minimum leverage and risk-based capital requirements for insured banks and their holding companies. The federal banking agencies issued a joint final rule, or the ''Final Capital Rule,'' that implements the Basel III capital standards and establishes the minimum capital levels required under the Dodd-Frank Act. We commenced compliance with the Final Capital Rule on January 1, 2015, and have been in compliance with that Rule through the phase in of increasingly stringent capital requirements in 2019. The Final Capital Rule establishes a minimum common equity Tier 1 capital ratio of 6.5% of risk-weighted assets for a ''well-capitalized'' institution and increases the minimum Tier 1 risk-based capital ratio for a ''well-capitalized'' institution from 6.0% to 8.0%. Additionally, the Final Capital Rule requires an institution to maintain a 2.5% common equity Tier 1 capital conservation buffer over the 6.5% minimum risk-based capital requirement to avoid restrictions on the ability to pay dividends, discretionary bonuses, and engage in share repurchases. The Final Capital Rule also increases the required capital for certain categories of assets, including high-volatility construction real estate loans, but retains the current capital treatment of residential mortgages. Under the Final Capital Rule, we made the election to exclude unrealized gains and losses from the calculation of our regulatory capital. Implementation of these standards, or any other new regulations, may adversely affect our ability to pay dividends, or require us to reduce business levels or raise capital, including in ways that may adversely affect our results of operations or financial condition.

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

On August 28, 2018, the Federal Reserve Board issued an interim final rule required by the EGRRCPA that expands the applicability of the Federal Reserve Board's small bank holding company policy statement (the "SBHC Policy Statement") to bank holding companies with total consolidated assets of less than $3 billion (up from the prior $1 billion threshold). Under the SBHC Policy Statement, qualifying bank holding companies have additional flexibility in the amount of debt they can issue and are also exempt from the Basel III capital standards (subsidiary depository institutions of qualifying bank holding companies are still subject to capital requirements). The Company currently has less than $3 billion in total consolidated assets and would likely qualify under the revised SBHC Policy Statement. However, the Company does not currently intend to issue a material amount of debt or take any other action that would cause its capital ratios to fall below the minimum ratios required by the Basel III capital standards.

On November 21, 2018, the federal banking agencies jointly issued a proposed rule required by the EGRRCPA that would permit qualifying banks and bank holding companies that have less than $10 billion in consolidated assets to elect to be subject to a 9% leverage ratio that would be applied using less complex leverage calculations (commonly referred to as the community bank leverage ratio or "CBLR"). Under the proposed rule, banks and bank holding companies that opt into the CBLR framework and maintain a CBLR of greater than 9% would not be subject to other risk-based and leverage capital requirements under the Basel III Capital Rules and would be deemed to have met the well capitalized ratio requirements under the "prompt corrective action" framework. The rule is in proposed form so the content and scope of the final rule, and its impact on the Company and the Bank (if any), cannot be determined. Consequently, the Company and the Bank cannot yet determine whether they intend to opt into the CBLR framework.

It is difficult to predict at this time what other specific impacts the Dodd-Frank Act and the remaining, yet-to-be-written implementing rules and regulations will have on community banks. However, compliance with the EGRRCPA, the Dodd-Frank Act and its implementing rules and regulations has resulted in, and is expected to continue to result in, increased operating and compliance costs.

Introduction

Banking is a complex, highly regulated industry. The primary goals of the regulatory scheme are to maintain a safe and sound banking system, protect depositors and the FDIC insurance fund, and facilitate the conduct of sound monetary policy. In furtherance of these goals, Congress and the states have created several largely autonomous regulatory agencies and enacted numerous laws that govern banks, bank holding companies and the financial services industry in general. Consequently, the growth and earnings performance of the Bank can be affected not only by management decisions and general economic conditions, but also by the requirements of applicable state and federal statues, regulations and the policies of various governmental regulatory authorities, including the Federal Reserve Board, the FDIC, and the banking authorities of each of the jurisdictions in which the Bank operates.

The Bank's business is also influenced by the monetary and fiscal policies of the federal government and the policies of regulatory agencies, particularly the Federal Reserve Board and the FDIC. The Federal Reserve Board implements national monetary policies (with objectives such as curbing inflation and combating unemployment) through its open-market operations in U.S. Government securities, by adjusting the required level of reserves for depository institutions subject to its reserve requirements, and by varying the target Federal Funds and discount rates applicable to borrowings by depository institutions. The actions of the Federal Reserve Board in these areas influence the growth of bank loans, investments and deposits, and also affect interest earned on interest-earning assets and paid on interest-bearing liabilities. The nature and impact of any future changes in monetary and fiscal policies on the Bank are difficult to predict.

The system of supervision and regulation applicable to financial services businesses governs most aspects of the business of the Bank, including: (i) the scope of permissible business; (ii) investments; (iii) reserves that must be maintained against deposits; (iv) capital levels that must be maintained; (v) the nature and amount of collateral that may be taken to secure loans; (vi) the establishment of new branches; (vii) mergers and consolidations with other financial institutions; and (viii) the payment of dividends.

From time to time, federal and local legislation is enacted which may have the effect of materially increasing the cost of doing business, limiting or expanding permissible activities, or affecting the competitive balance between banks and other financial services providers. In addition, the various bank regulatory agencies often adopt new rules, regulations and policies to implement and enforce existing legislation. It cannot be predicted whether, or in what form, any such legislation or regulations or changes in policy may be enacted, or the extent to which the business of the Bank or the Company would be affected thereby. The Bank cannot predict whether or when potential legislation will be enacted and, if enacted, the effect that it, or any implemented regulations and supervisory policies, would have on our financial condition or results of operations. In addition, the outcome of examinations, any litigation or any investigations initiated by federal or local authorities may result in necessary changes in our operations that may increase our costs.

Set forth below is a description of the significant elements of the laws and regulations applicable to the Company and the Bank. The description is qualified in its entirety by reference to the full text of the statutes, regulations and policies that are described. Also, such statutes, regulations and policies are continually under review by the U.S. Congress and local legislatures and federal and local regulatory agencies, and, where applicable, their foreign counterparts. A change in statutes, regulations or regulatory policies applicable to the Company or the Bank could have a material effect on our business.

Regulation of BankGuam Holding Company

As a bank holding company, the Company is registered under the Bank Holding Company Act of 1956, as amended ("BHCA"), and is subject to regulation and periodic examination by the Federal Reserve Board. The Company is also required to file periodic reports of its operations and any additional information regarding its activities and those of its subsidiaries, as may be required by the Federal Reserve Board.

Federal Reserve Board regulations require bank holding companies to act as a source of financial and managerial strength to their subsidiary banks. Under these regulations, the holding company is expected to commit resources to support its bank subsidiary, including at times when the holding company may not be in a financial position to provide such support. Bank holding companies must also maintain the financial flexibility and capital raising capacity to obtain additional resources for assisting their subsidiary bank. A bank holding company's failure to meet its obligations to serve as a source of strength to its subsidiary bank will generally be considered by the Federal Reserve Board to be an unsafe and unsound banking practice, a violation of the Federal Reserve Board's regulations, or both.

Under the BHCA, a bank holding company must obtain the Federal Reserve Board's approval before: (i) directly or indirectly acquiring more than 5% ownership or control of any voting shares of another bank or bank holding company; (ii) acquiring all or substantially all of the assets of another bank; or (iii) merging or consolidating with another bank holding company.

The business activities of the Company, as a bank holding company, are restricted by the BHCA. Under the BHCA and the Federal Reserve's bank holding company regulations, the Company may only engage in, acquire or control voting securities or assets of a company engaged in: (i) banking, or managing or controlling banks and other subsidiaries authorized under the BHCA; and, (ii) any non-banking activity the Federal Reserve has determined to be so closely related to banking or managing or controlling banks as to be a proper incident thereto. These include any incidental activities necessary to carry on those activities as well as a variety of activities that the Federal Reserve has determined to be so closely related to the business of banking as to be a proper incident thereto.

There are various restrictions on the ability of the holding company to borrow from, and engage in certain other transactions with, its bank subsidiary. In general, these restrictions require that any extensions of credit by the Bank to any single affiliate of the Bank must be secured by designated amounts of specified collateral and are limited to 10% of the Bank's capital stock and surplus, and, as to the Company and all other affiliates of the Bank collectively, to 20% of the Bank's capital stock and surplus. Federal law also provides that extensions of credit and other transactions between the Bank and the Company must be on terms and conditions, including credit standards, that are substantially the same or at least as favorable to the Bank as those prevailing at the time for comparable transactions involving non-affiliated companies or, in the absence of comparable transactions, on terms and conditions, including credit standards, that in good faith would be offered to or would apply to non-affiliated companies.

Federal law prohibits a bank holding company and any subsidiary banks from engaging in certain tie-in arrangements in connection with the extension of credit. Thus, for example, the Bank may not extend credit, lease or sell property, or furnish any services, or fix or vary the consideration for any of the foregoing on the condition that: (i) the customer must obtain or provide some additional credit, property or services from or to the Bank other than a loan, discount, deposit or trust services; (ii) the customer must obtain or provide some additional credit, property or service from or to the Company or the Bank; or, (iii) the customer must not obtain some other credit, property or services from competitors, except reasonable requirements to ensure soundness of the credit extended.

The principal source of the Company's cash revenues are dividends from its subsidiary, the Bank. The Company's earnings and activities are affected by legislation, by regulations and by local legislative and administrative bodies and decisions of courts in the jurisdictions in which we conduct business. For example, these include limitations on the ability of the Bank to pay dividends to the Company and our ability to pay dividends to our stockholders. It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year and only if prospective earnings retention is consistent with the organization's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiary.

Regulation of the Bank

General. As a Guam-chartered bank, the Bank is subject to supervision, periodic examination and regulation by the Guam Banking Commission. As a member of the Federal Deposit Insurance Corporation, the Bank is also subject to supervision, periodic examination and regulation by the FDIC as the Bank's primary federal regulator. If, as a result of an examination, the Guam Banking Commission or the FDIC should determine that the financial condition, capital resources, asset quality, earnings prospects, management, liquidity, or other aspects of the Bank's operations are unsatisfactory, or that the Bank or its management is violating or has violated any law or regulation, the Guam Banking Commission and the FDIC have residual authority to: (i) require affirmative action to correct any conditions resulting from any violation or practice; (ii) direct an increase in capital; (iii) restrict the Bank's growth geographically, by products and services, or by mergers and acquisitions; (iv) enter into informal nonpublic or formal public memoranda of understanding or written agreements; (v) enjoin unsafe and unsound practices and issue cease and desist orders to take corrective action; (vi) remove officers and directors and assess civil monetary penalties; and, (vii) take possession of, close and liquidate the Bank.

Guam law permits locally-chartered commercial banks to engage in any activity permissible for national banks. Therefore, the Bank may form subsidiaries to engage in the many so-called "closely related to banking" or "nonbanking" activities commonly conducted by national banks in operating subsidiaries, and further, pursuant to the Gramm-Leach-Bliley Act, the Bank may conduct certain "financial" activities in a subsidiary to the same extent as may a national bank, provided the Bank is and remains "well-capitalized," "well-managed" and in satisfactory compliance with the Community Reinvestment Act (discussed below).

The Bank is a member of the Federal Home Loan Bank ("FHLB") of Des Moines. Among other benefits, each FHLB serves as a reserve or central bank for its members within its assigned region and makes available loans or advances to its members. Each FHLB is financed primarily from the sale of consolidated obligations of the FHLB system. As an FHLB member, the Bank is required to own a certain amount of capital stock in the FHLB. At December 31, 2019, the Bank was in compliance with the FHLB's stock ownership requirement.

Regulatory Capital Guidelines. The federal banking agencies have established minimum capital standards known as risk-based capital guidelines. These guidelines are intended to provide measures of capitalization that reflect the degree of risk associated with a bank's operations. The risk-based capital guidelines include both a definition of capital and a framework for calculating the amount of capital that must be maintained against a bank's assets and off-balance sheet items. The amount of capital required to be maintained is based upon the credit risks associated with the various types and quality of a bank's assets and off-balance sheet items. A bank's assets and off-balance sheet items are classified under several risk categories, with each category assigned a particular risk weighting from 0% to 150%. The Bank's Tier 1 capital consists of its capital stock, capital surplus, treasury stock, undivided earnings and the cumulative effect of the FDIC's adjustment of our intangible assets. Our Tier 2 capital adds to Tier 1 the allowed portion of our reserves for possible loan losses. The inclusion of Tier 2 capital as qualifying capital for regulatory purposes is subject to certain other requirements and limitations of the federal banking agencies. The federal regulators require a minimum ratio of total qualifying capital to risk-adjusted assets of 8.0%, a minimum ratio of Tier 1 capital to risk-adjusted assets of 6.0%, a minimum amount of Tier 1 capital to total assets (referred to as the "leverage ratio") of 4% and a minimum ratio of Common Equity Tier 1 Capital to risk-adjusted assets of 4.5%. As of December 31, 2018, the Company's capital levels met all minimum regulatory requirements and the Bank was considered "well capitalized" under the regulatory framework for prompt corrective action described below. There is no condition or event since December 31, 2018, that management believes has changed the Company's or the Bank's capitalization category.

As described above, on November 21, 2018, the federal banking agencies jointly issued a proposed rule required by the EGRRCPA that would permit qualifying banks and bank holding companies that have less than $10 billion in consolidated assets to elect to opt into the CBLR framework. Banks opting into the CBLR framework and maintaining a CBLR of greater than 9% would be deemed to have met the well capitalized ratio requirements under the "prompt corrective action" framework. The rule is in proposed form so the content and scope of the final rule, and its impact on the Company and the Bank (if any), cannot be determined. Consequently, the Company and the Bank cannot yet determine whether they intend to opt into the CBLR framework.

Prompt Corrective Action. The federal banking agencies possess broad powers to take prompt corrective action to resolve the problems of regulated banks. Each federal banking agency has issued regulations defining five capital categories: "well capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized," and "critically undercapitalized." Under the regulations, a bank shall be deemed to be:

- "well capitalized" if it has a total risk-based capital ratio of 10.0% or more, has a Tier 1 risk-based capital ratio of 8.0% or more, has a leverage capital ratio of 5.0% or more, and a Common Equity Tier 1 risk-based capital ratio of 6.5% or more, and is not subject to specified requirements to meet and maintain a specific capital level for any capital measure;
- "adequately capitalized" if it has a total risk-based capital ratio of 8.0% or more, a Tier 1 risk-based capital ratio of 6.0% or more, a leverage capital ratio of 4.0% or more, and a Common Equity Tier 1 risk-based capital ratio of 4.5% or more, and does not meet the definition of "well capitalized";
- "undercapitalized" if it has a total risk-based capital ratio that is less than 8.0%, a Tier 1 risk-based capital ratio that is less than 6.0%, a leverage capital ratio that is less than 4.0% (3.0% under certain circumstances), or a Common Equity Tier 1 risk-based capital ratio that is less than 4.5%;
- "significantly undercapitalized" if it has a total risk-based capital ratio that is less than 6.0%, a Tier 1 risk-based capital ratio that is less than 4.0%, a leverage capital ratio that is less than 3.0%, or a Common Equity Tier 1 risk-based capital ratio that is less than 3.0%; and
- "critically undercapitalized" if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%.

Banks are prohibited from paying dividends or management fees to controlling persons or entities if, after making the payment, the bank would be "undercapitalized," that is, the bank fails to meet the required minimum level for any relevant capital measure. Asset growth and branching restrictions apply to "undercapitalized" banks. Banks classified as "undercapitalized" are required to submit acceptable capital plans guaranteed by their holding company, if any. Broad regulatory authority was granted with respect to "significantly undercapitalized" banks, including forced mergers, growth restrictions, ordering new elections for directors, forcing divestiture by their holding company, if any, requiring management changes, and prohibiting the payment of bonuses to senior management. Even more severe restrictions are applicable to "critically undercapitalized" banks, those with capital at or less than 2%. Restrictions for these banks include the appointment of a receiver or conservator. All of the federal banking agencies have promulgated substantially similar regulations to implement this system of prompt corrective action.

A bank, based upon its capital levels, that is classified as "well capitalized," "adequately capitalized" or "undercapitalized" may be treated as though it were in the next lower capital category if the appropriate federal banking agency, after notice and opportunity for a hearing, determines that an unsafe or unsound condition, or an unsafe or unsound practice, warrants such treatment. At each successive lower capital category, an insured bank is subject to more restrictions. The federal banking agencies, however, may not treat an institution as "critically undercapitalized" unless its capital ratios actually warrant such treatment.

In addition to measures taken under the prompt corrective action provisions, insured banks may be subject to potential enforcement actions by federal banking agencies, or the banking regulators in any of the jurisdictions in which the Bank operates, for unsafe or unsound practices in conducting their businesses, or for violations of any law, rule, regulation or any condition imposed in writing by the agency, or any written agreement with the agency. Enforcement actions may include the imposition of a conservator or receiver, the issuance of a cease-and-desist order that can be judicially enforced, the termination of insurance of deposits (in the case of a depository institution), the imposition of civil money penalties, the issuance of directives to increase capital, the issuance of formal and informal agreements, and the issuance of removal and prohibition orders against "institution-affiliated" parties. The enforcement of such actions through injunctions or restraining orders may be based upon a judicial determination that the agency would be harmed if such equitable relief was not granted.

Neither the Company nor the Bank is currently operating under any corrective actions by their respective regulatory authorities.

Safety and Soundness Standards. The federal banking agencies have also adopted guidelines establishing safety and soundness standards for all insured depository institutions, as have the other regulatory authorities in jurisdictions in which the Bank operates. Those guidelines relate to internal controls, information systems, internal audit systems, loan underwriting and documentation, compensation and interest rate exposure. In general, the standards are designed to assist the various banking authorities in identifying and addressing problems at depository institutions before capital becomes impaired. If an institution fails to meet these standards, the appropriate banking authority may require the institution to submit a compliance plan and may institute enforcement proceedings if an acceptable compliance plan is not submitted.

FDIC Insurance and Insurance Assessments. The FDIC is an independent federal agency that insures deposits, up to prescribed statutory limits, of federally insured banks and savings institutions, and safeguards the safety and soundness of the banking and savings industries. The FDIC insures the Bank's customer deposits through the Deposit Insurance Fund ("DIF"). The maximum deposit insurance amount is $250,000.

The amount of FDIC assessments paid by each DIF member institution is based on its relative risk of default as measured by regulatory capital ratios and other supervisory factors. Pursuant to the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the FDIC is required to set the reserve ratio for the DIF annually at no less than 1.35% of estimated insured deposits. The FDIC may increase or decrease the assessment rate schedule on a semi-annual basis.

On February 7, 2011, as required by the Dodd-Frank Act, the FDIC adopted final rules to revise the assessment base to consist of average consolidated total assets during the assessment period minus the average tangible equity during the assessment period. In addition, the revisions eliminate the adjustment for secured borrowings and make certain other changes to the impact of unsecured borrowings and brokered deposits on an institution's deposit insurance assessment. The rule also revises the assessment rate schedule to provide assessments ranging from 5 to 45 basis points, which took effect on April 1, 2011.

The FDIC may terminate a depository institution's deposit insurance upon a finding that the institution's financial condition is unsafe or unsound or that the institution has engaged in unsafe or unsound practices that pose a risk to the DIF or that may prejudice the interest of depositors.

Depositor Preference. In the event of the "liquidation or other resolution" of an insured depository institution, the claims of depositors of the institution, including the claims of the FDIC as subrogee of insured depositors, and certain claims for administrative expenses of the FDIC as a receiver, will have priority over other general unsecured claims against the institution. If an insured depository institution fails, insured and uninsured depositors, along with the FDIC, will have priority in payment ahead of unsecured, non-deposit creditors, including the parent bank holding company, with respect to any extensions of credit they have made to such insured depository institution.

Community Reinvestment Act ("CRA"). The CRA is intended to encourage insured depository institutions, while operating safely and soundly, to help meet the credit needs of their communities. The CRA specifically directs the federal bank regulatory agencies, in examining insured depository institutions, to assess their record of helping to meet the credit needs of their entire community, including low- and moderate-income neighborhoods, consistent with safe and sound banking practices. The CRA further requires the agencies to take a financial institution's record of meeting its community credit needs into account when evaluating applications for, among other things, domestic branches, consummating mergers or acquisitions, or holding company formations.

The federal banking agencies have adopted regulations which measure a bank's compliance with its CRA obligations on a performance-based evaluation system. This system bases CRA ratings on an institution's actual lending service and investment performance rather than the extent to which the institution conducts needs assessments, documents community outreach or complies with other procedural requirements. The ratings range from "outstanding" to a low of "substantial noncompliance." The Bank had a CRA rating of "satisfactory" as of its most recent regulatory examination. A copy of the rating report is publicly available for review in the Bank's branches.

Other Consumer Protection Laws and Regulations. The bank regulatory agencies are increasingly focusing attention on compliance with consumer protection laws and regulations, and banks have been advised to carefully monitor their compliance with these laws and regulations. The federal Interagency Task Force on Fair Lending issued a policy statement on discrimination in home mortgage lending describing three methods that federal agencies will use to prove discrimination: overt evidence of discrimination, evidence of disparate treatment, and evidence of disparate impact. In addition to CRA and fair lending requirements, the Bank is subject to numerous other federal consumer protection statutes and regulations. Due to heightened regulatory concern related to compliance with consumer protection laws and expanded regulations generally, the Bank may incur additional compliance costs or be required to expend additional funds for investments in the local communities it serves.

Privacy. The Federal Reserve Board and other bank regulatory agencies have adopted guidelines for safeguarding confidential, personal customer information. These guidelines require financial institutions to create, implement and maintain a comprehensive written information security program designed to ensure the security and confidentiality of customer information, protect against any anticipated threats or hazards to the security or integrity of such information, and protect against unauthorized access to or use of such information that could result in substantial harm or inconvenience to any customer. The Bank has adopted a customer information security program to comply with these requirements.

Financial institutions are also required to implement policies and procedures regarding the disclosure of nonpublic personal information about consumers to non-affiliated third parties. In general, financial institutions must provide explanations to consumers on policies and procedures regarding the disclosure of such nonpublic personal information, and, except as otherwise required by law, prohibits disclosing such information except as provided in the Bank's policies and procedures. The Bank has implemented privacy policies addressing these restrictions, and these policies are distributed regularly to all existing and new customers of the Bank.

USA Patriot Act of 2001. Under the USA Patriot Act of 2001 (the "Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act," or the "Patriot Act"), financial institutions are subject to prohibitions regarding specified financial transactions and account relationships, as well as enhanced due diligence and "know your customer" standards in their dealings with foreign financial institutions and foreign customers. Among other things, the Patriot Act requires: (i) enhanced due diligence policies, procedures, and controls on banks opening or holding accounts for foreign banks or wealthy foreign individuals; and, (ii) requires all financial institutions to establish anti-money laundering programs. The Bank has adopted and implemented policies and procedures to comply with the requirements of the Patriot Act.

Office of Foreign Assets Control Regulation. The United States has imposed economic sanctions that affect transactions with designated foreign countries, nationals and others. These are typically known as the "OFAC" rules based on their administration by the U.S. Treasury Department Office of Foreign Assets Control ("OFAC"). The OFAC-administered sanctions targeting countries take many different forms. Generally, however, they contain one or more of the following elements: (i) restrictions on trade with or investment in a sanctioned country, including prohibitions against direct or indirect imports from and exports to a sanctioned country and prohibitions on "U.S. persons" engaging in financial transactions relating to making investments in, or providing investment-related advice or assistance to, a sanctioned country; and, (ii) a blocking of assets in which the government or specially designated nationals of the sanctioned country have an interest, by prohibiting transfers of property subject to U.S. jurisdiction (including property in the possession or control of U.S. persons). Blocked assets (e.g., property and bank deposits) cannot be paid out, withdrawn, set off or transferred in any manner without a license from OFAC. Failure to comply with these sanctions could have serious legal and reputational consequences, including civil money penalties and potential criminal prosecution. The Bank has established policies and implemented procedures to detect and prohibit transactions that would violate the OFAC rules.

Other Aspects of Banking Law. The Bank is also subject to federal statutory and regulatory provisions covering, among other things, security procedures, insider and affiliated party transactions, management interlocks, electronic funds transfers, funds availability, and truth-in-savings.

Other Pending and Proposed Legislation

Other legislative and regulatory initiatives which could affect the Bank, the Company and the banking industry in general may be proposed or introduced before the United States Congress, the Guam legislature and other governmental bodies in the future. Such proposals, if enacted, may further alter the structure, regulation and competitive relationship among financial institutions, and may subject the Bank or the Company to increased regulation, disclosure and reporting requirements. In addition, the various banking regulatory agencies often adopt new rules and regulations to implement and enforce existing legislation. It cannot be predicted whether, or in what form, any such legislation or regulations may be enacted or the extent to which the business of the Bank or the Company would be affected thereby.

Available Information

The Company makes available free of charge through the Bank's website (www.bankofguam.com) the Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to these reports. The Company makes these reports available on the Bank's website as soon as reasonably practicable after we electronically file such material with, or otherwise furnish it to, the SEC. The information posted on our website is not incorporated by reference into this Annual Report. The SEC maintains a website that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at www.sec.gov.

ITEM 1A. Risk Factors

Our business, financial condition and results of operations are subject to various risks, including those discussed below. The risks discussed are those that we believe are the most significant risks, although additional risks not presently known to us or that we currently deem less significant may also adversely affect our business, financial condition and results of operations, perhaps materially.

Risks Relating to Recent Economic Conditions and Governmental Response Efforts

Our business may be adversely affected by conditions in the financial markets and economic conditions generally.

The United States economy continues to recover from a downturn that started in 2007, but business activity and growth across industries and regions have not yet been fully restored. In 2019, the Federal Open Market Committee, which guides current monetary policy actions on behalf of the Federal Reserve System in carrying out its broader monetary policies lowered its target interest rate after several raises in 2018. Consumer spending, liquidity and availability of credit are all improving, and the unemployment rate, which has fallen by more than half since October 2009, reached what many consider to be a full-employment level nationally. The unemployment rate in our California region is low, but has been persistently high in the island markets we serve.

The financial services industry was materially and adversely affected by the weakened economy and by the monetary policy responses intended to correct that weakness. The negative effect of historically low market interest rates reduced our interest rate margin despite us having established minimum rate levels on our variable rate loans. In order to retain core deposits and as a reputational matter, our consumer savings account rates have been higher than our competitors' offerings for the past nine years. The recovery of the economy and gradual reduction of unemployment impacted our operating results negatively; however, the Bank has not experienced any adverse liquidity issues in recent years. Additionally, the remaining adverse conditions in the island economies may continue to have a negative effect on the ability of our borrowers to make timely repayments of their loans. These factors could expose us to an increased risk of loan defaults and losses, and have an adverse impact on our earnings.

Recent legislative and required regulatory initiatives will impose restrictions and requirements on financial institutions that could have an adverse effect on our business.

Current and future legal and regulatory requirements, restrictions, and regulations, including those imposed under the 2010 Dodd-Frank Act, which was enacted in response to the 2008 financial crisis and subsequent economic weakness, may adversely impact our profitability, financial condition and operations; may require us to invest significant management attention and resources to evaluate and make any changes required by the legislation and related regulations; and may make it more difficult for us to attract and retain qualified executive officers and employees. Few provisions of the Dodd-Frank Act were effective immediately, with various provisions becoming effective in stages. Many of the provisions required governmental agencies to implement rules that have increased regulation of the banking industry. As examples, these rules impact the ability of banks to charge certain fees and impose new restrictions on lending practices. The Dodd-Frank Act created a new financial consumer protection agency, known as the Consumer Financial Protection Bureau (the "Bureau"), that is empowered to promulgate new consumer protection regulations and revise existing regulations in many areas of consumer compliance, which may increase our regulatory compliance burden and costs, and may restrict the financial products and services we offer to our customers.

The Dodd-Frank Act prohibits new trust preferred issuances from counting as Tier 1 capital. These restrictions limit our future capital strategies. Although neither the Bank nor the Company use derivative transactions, the Dodd-Frank Act also increases regulation of derivatives and hedging transactions, which could limit our ability in the future to enter into, or increase the costs associated with, interest rate and other hedging transactions. Although certain provisions of the Dodd-Frank Act, such as direct supervision by the Bureau, will not apply to banking organizations with less than $10 billion of assets, such as the Company, the changes resulting from the legislation will impact our business nonetheless. These and future changes may have a material, adverse effect on our business, our financial condition and the results of our operations. As discussed above, the EGRRCPA adopted in 2018 amended certain provisions of the Dodd-Frank Act as well as certain other statutes administered by the federal bank regulatory agencies. No other significant banking or bank holding company regulations were implemented during 2018.

On December 22, 2017, the Tax Cuts and Jobs Act ("the Act") was signed into law. Most of the changes made to the Internal Revenue Code by the Act became effective January 1, 2018. The lowering of the maximum corporate income tax rate from 35% to 21% required a revaluation of the Company's deferred tax asset during the 2017 tax year, which resulted in a one-time negative effect on our profitability and our financial condition. During the years ended December 31, 2018 and 2019, the Act had a substantial effect on the Company's and the Bank's net income after income taxes, primarily due to the reduction in the effective corporate income tax rate.

Implementation of the new Basel III capital rules adopted by the federal bank regulatory agencies will require increased capital levels that could impede our growth and profitability.

The federal bank regulatory agencies adopted new capital requirements in mid-2013 that increased the minimum Tier 1 risk-based capital ratio, added a new minimum common equity Tier 1 capital ratio, established a new capital conservation buffer and changed the risk-weighting of certain assets. These requirements, initially implemented beginning in January 2015, were phased in through 2019. Although we currently exceed the new minimum requirements, they could have a material and adverse effect on our liquidity, capital resources, financial performance and financial condition in the future.

Any future FDIC insurance premium increases will adversely affect our earnings.

In April 2009, the FDIC revised its risk-based assessment system. The changes to the system involve adjustments to the risk-based calculation of an institution's unsecured debt, secured liabilities and brokered deposits. Depending on any future losses that the FDIC Deposit Insurance Fund may suffer due to failed institutions, there can be no assurance that there will not be additional premium increases in order to replenish the Fund, but the rate of bank failures has diminished over the past four years, returning to historical norms. Our FDIC deposit insurance expense for the year ended December 31, 2019, was $889.0 thousand.

Risks Related to Our Markets and Business

Our profitability is dependent upon the economic conditions of the markets in which we operate.

We operate on ten relatively remote Pacific islands and in San Francisco, California, and, as a result, our financial condition and results of operations are affected by changes in the economic conditions in each of those areas. Our success depends upon the business activity, population, income levels, deposits and lending activity in these markets. Because some of our customers' business and financial interests may extend well beyond these market areas, adverse economic conditions that affect those other market areas could reduce our growth rate, affect the ability of those customers to repay their loans, and generally affect our financial condition and results of operations. Other than in San Francisco, our lending operations are located in market areas dependent on tourism and fishing, along with a military presence and other federal government activities in Guam. The island economies have remained relatively stable, and the Commonwealth of the Northern Mariana Islands has resumed its economic growth after several years of challenges. However, because of the magnified influence of external events, these small island economies tend to be somewhat more volatile than larger economic systems. Thus, our borrowers could be adversely impacted by a downturn in these sectors of the economy that could reduce the demand for loans and adversely impact the borrowers' ability to repay their loans, which would, in turn, increase our nonperforming assets. Because of our geographic concentration in several relatively small island economies, we are less able than many regional or national financial institutions to diversify our credit risks across multiple dissimilar markets. In recent years, we have taken the initiative to expand our operations in California in an effort to increase and help to stabilize our profitability.

Our loan portfolio has a large concentration of real estate loans in Guam and in San Francisco, which involves risks specific to real estate values.

A downturn in our real estate markets could adversely affect our business because many of our loans are secured by real estate. Real estate lending (including commercial and construction) is a large portion of our loan portfolio. At December 31, 2019, approximately $789.4 million, or 60.4% of our loan portfolio, was secured by various forms of real estate, including residential and commercial real estate. The real estate securing our loan portfolio is concentrated in Guam and San Francisco. From time to time, there have been adverse developments affecting real estate values in one or more of our markets, and the market value of real estate can fluctuate significantly in a short period of time as a result of changing market conditions. Real estate values and real estate markets are generally affected by changes in national, regional or local economic conditions, fluctuations in interest rates and the availability of loans to potential purchasers, changes in tax laws and other governmental statutes, regulations and policies, and acts of nature, such as earthquakes and typhoons. Additionally, commercial real estate lending typically involves larger loan principal amounts and the repayment of the loans generally is dependent, in large part, on sufficient income from the properties securing the loans to cover operating expenses and debt service. If real estate values decline, the value of the collateral securing some of our loans could be significantly reduced. Our ability to recover on defaulted loans by foreclosing and selling the real estate collateral would then be diminished, and we would be more likely to suffer losses on defaulted loans.

If we fail to maintain an effective system of internal controls and disclosure controls and procedures, we may not be able to accurately report our financial results or prevent fraud.

Effective internal control over financial reporting and disclosure controls and procedures are necessary for us to provide reliable financial reports, effectively prevent fraud and to operate successfully as a public company. If we cannot provide reliable financial reports or prevent fraud, our reputation and business would be harmed. In addition, failure in our internal control over financial reporting and disclosure controls and procedures could cause us to fail to meet the requirements of Rules 13a-15 and 15d-15 under the Exchange Act and, as a result, risk errors in our financial reporting to the Securities and Exchange Commission.

Each calendar quarter, management conducts an assessment of the effectiveness of the Company's internal control over financial reporting based on the framework established in *Internal Control-Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. For additional information on the effectiveness of our internal controls over financial reporting, see Part II. Item 9A. "Controls and Procedures" in this Annual Report on Form 10-K.

Our performance depends on attracting and retaining key employees and skilled personnel to operate our business effectively, and the loss of one or more of those key personnel may materially and adversely affect our prospects.

Our success is dependent on our ability to recruit and retain qualified, skilled management, loan origination, finance, administrative, marketing and technical personnel to operate our business effectively. Competition for qualified employees and personnel in the banking industry is intense, and there is a limited number of persons with knowledge of, and experience in, the community banking industry in the markets we serve. In particular, our success has been and continues to be highly dependent upon the abilities of key executives, including our Chief Executive Officer, our Chief Operating Officer, our Chief Financial Officer, and certain other key employees. Failure to maintain adequate staffing in key positions could adversely impact our operations and our ability to compete.

Effective April 1, 2019 the Company's and Bank's Board appointed William D. Leon Guerrero, as the Chairman of the Board of Directors, Joaquin P.L.G. Cook, as President and Chief Executive Officer, and Maria Eugenia H. Leon Guerrero, as Executive Vice President and Chief Operating Officer of the Company and the Bank.

We are subject to credit risk.

There are inherent risks associated with our lending activities. These risks include, among other things, the impact of changes in interest rates and changes in the economic conditions in the markets where we operate, as well as those within our region, across the United States and abroad. Increases in interest rates and/or weakening economic conditions could adversely impact the ability of borrowers to repay outstanding loans or the value of the collateral securing those loans. We are also subject to various laws and regulations that affect our lending activities. Failure to comply with applicable laws and regulations could subject us to regulatory enforcement action, which could result in the assessment of significant civil money penalties against us.

We seek to mitigate the risks inherent in our loan portfolio by adhering to specific underwriting practices. Although we believe that our underwriting criteria are appropriate for the various kinds of loans we make, we may incur losses on loans that meet our underwriting standards, and these losses may exceed the amounts set aside as reserves in our allowance for loan losses. Due to economic conditions in the recent past, many lending institutions, including the Bank, experienced declines in the performance of their loans, including consumer and commercial loans. The value of real estate collateral supporting some commercial loans declined and may decline again in the future. Developments in the financial industry and credit markets may adversely impact our financial condition and results of operations.

Our allowance for loan losses may not be adequate to cover actual loan losses, which could adversely affect our earnings.

We maintain an allowance for loan losses for possible defaults and other reductions in the principal value of the Bank's loan portfolio. The allowance is established through a provision for loan losses based on management's evaluation of the risks inherent in the loan portfolio and the general economy. The allowance is also appropriately increased for new loan growth. The allowance is based upon a number of factors, including the size of the loan portfolio, asset classifications, economic trends, industry experience and trends, industry and geographic concentrations, estimated collateral values, management's assessment of the credit risk inherent in the portfolio, historical loan loss experience and loan underwriting policies.

We strive to carefully manage and monitor credit quality and to identify deteriorating loans, and adjust the allowance for loan losses accordingly. However, because future events are uncertain and because we may not successfully identify all deteriorating loans in a timely manner, there may be loans that deteriorate in an accelerated time frame. As a result, future additions to the allowance may be necessary. Further, because the loan portfolio contains some commercial real estate, construction, and land development loans with relatively large balances, deterioration in the credit quality of one or more of these loans may require a significant increase to the allowance for loan losses. Future additions to the allowance may also be required due to changes in the financial condition of borrowers, such as changes resulting from potentially worsening economic conditions, or as a result of incorrect assumptions by management in determining the allowance for loan losses. As discussed in Note 6, in 2019 two commercial loan borrowers filed for bankruptcy. The first borrower filed on January 16, 2019, with an outstanding relationship of $9.2 million in unsecured loans as of December 31, 2019, sought bankruptcy protection in order to reorganize under Chapter 11 of Title 11 of the United States Code. The Bank retains the right of offset against a minimum of $5.2 million in the customer's depository accounts, and has made a specific allowance for loan losses of $5.2 million at December 31, 2019. The second borrower filed for bankruptcy on April 30, 2019, with an outstanding relationship of $2.3 million at December 31, 2019. The loans were secured with commercial real estate, business assets, and two loans had a state guaranty. The value of the properties securing the loans total $1.8 million and the Bank has made a specific allowance for loan losses of $933 thousand at December 31, 2019.

Our regulators, as an integral part of their examination process, periodically review our allowance for loan losses and may require us to increase our allowance for loan losses by making additional provisions for loan losses, charged as an expense, or to decrease our allowance for loan losses by recognizing loan charge-offs, net of recoveries. Any such additional provisions for loan losses or charge-offs, as required by these regulatory agencies, could have a material adverse effect on our financial condition and results of operations.

Nonperforming assets take significant time to resolve and adversely affect our results of operations and financial condition.

At December 31, 2019, nonperforming loans were 0.84% of the total loan portfolio, and 0.57% of total assets, as compared to 0.57% and 0.37% at December 31, 2018, respectively, indicating a decreased level of risk. Nonperforming assets adversely affect our earnings in various ways. Depending upon economic and market conditions, we may incur losses relating to an increase in nonperforming assets. We do not record interest income on non-accrual loans or other real estate owned, thereby adversely affecting our income, and increasing our loan administration costs. Upon foreclosure or similar proceedings, we record the foreclosed asset at the fair value of the asset, reduced by estimated selling costs, which may result in a loss. An increase in the level of nonperforming assets increases our risk profile and may impact the capital levels our regulators believe are appropriate in light of the increased risk profile. While we reduce problem assets through collection efforts, asset sales, workouts, restructurings and otherwise, decreases in the value of the underlying collateral or in these borrowers' performance or financial condition, whether or not due to economic and market conditions beyond our control, could adversely affect our business, our results of operations and our financial condition.

In addition, the resolution of nonperforming assets requires significant commitments of time from management and our directors, which can hinder the performance of their other responsibilities. If economic and market conditions worsen, it is possible that we will experience future increases in nonperforming assets, particularly if we are unsuccessful in our efforts to reduce our classified assets, which would have an adverse effect on our business.

We may be required to make additional provisions for loan losses and charge off additional loans in the future, which could adversely affect our results of operations.

For the year ended December 31, 2019, we recorded a $9.8 million provision for loan losses, charged off $7.9 million of loans, and recovered $2.2 million of loans previously charged off. At December 31, 2019, we had $789.4 million in commercial and residential real estate loans and construction loans, of which $11.5 million was on non-accrual. Nonperforming commercial & industrial loans comprise of 15.2% of our nonperforming assets, commercial real estate loans comprise 11.1%, and residential mortgage loans comprise 8.3%. Deterioration in the real estate market in Guam, San Francisco and/or the Commonwealth of the Northern Mariana Islands could affect the ability of our loan customers to service their debt, which could result in additional loan charge-offs and provisions for loan losses in the future, and could have a material adverse effect on our financial condition, results of operations and capital.

Two commercial loan borrowers filed for bankruptcy in 2019, and were evaluated under ASC 450 – *"Contingencies"*. The first borrower filed for bankruptcy in January 2019 and the Bank holds $5.8 million in deposits for which the Court has approved a right of offset against the borrower's loans. The Bank also has assigned a specific allowance of $5.2 million to the outstanding debt. The outstanding loans under bankruptcy have been classified as doubtful, but the borrower continues making the scheduled payments to the loans. The second borrower filed for bankruptcy in April 2019, and the bank has assigned a specific allowance of $933 thousand to outstanding debt. The banks management feels both loan borrowing relationships are adequately reserved.

Our business is subject to interest rate risk, and variations in interest rates may negatively affect our financial performance.

Our earnings and cash flows are highly dependent upon net interest income. Net interest income is the difference between interest income earned on interest-bearing assets, such as loans and securities, and interest expense paid on interest-bearing liabilities, such as deposits and borrowed funds. Our net interest income (including net interest spread and margin) and ultimately our earnings are impacted by changes in interest rates and monetary policy. Changes in interest rates and monetary policy can impact the demand for new loans, the credit profile of our borrowers, the yields earned on loans and securities, and the rates paid on deposits and borrowings. Given our current volume and mix of interest-bearing liabilities and interest-earning assets, we expect our interest rate spread (the difference in the rates paid on interest-bearing liabilities and the yields earned on interest-earning assets) as well as net interest income to increase as interest rates rise and, conversely, to decline if interest rates fall. Additionally, increasing levels of in-market and out-of-market competition in the banking and financial services business may decrease our net interest spread as well as net interest margin by forcing us to offer lower lending interest rates and pay higher deposit interest rates. Although we believe our current level of interest rate sensitivity is reasonable, significant fluctuations in interest rates (such as a sudden and substantial increase in Prime and Fed Funds rates) as well as increasing competition may require us to increase rates on deposits at a faster pace than the yield we receive on interest-earning assets increases. The impact of any sudden and substantial move in interest rates and/or increased competition may have an adverse effect on our business, financial condition and results of operations, as our net interest income may be adversely affected.

Additionally, a sustained decrease in market interest rates could negatively affect our earnings. When interest rates decline, borrowers tend to refinance higher-rate, fixed-rate loans at lower rates, prepaying their existing loans. Under those circumstances, we would not be able to reinvest those prepayments in assets earning interest rates as high as the rates on the prepaid loans. In addition, our commercial loans, which carry variable interest rates that generally adjust in accordance with changes in the prime rate, will adjust to lower rates. Because of this, we have established minimum interest rates on those loans to mitigate our interest rate risk and potential reductions in income.

We are also significantly affected by the level of loan demand available in our markets. The inability to make sufficient loans directly affects the interest income we earn. Lower loan demand will generally result in lower interest income realized as we place funds in lower-yielding investments.

Liquidity risk could impair our ability to fund operations and jeopardize our financial condition.

Liquidity is essential to our business. An inability to raise funds through deposits, borrowings, the sale of loans and other sources could have a substantial negative effect on our liquidity. Our access to funding sources in amounts adequate to finance our activities could be impaired by factors that affect us specifically or the financial services industry in general. Factors that could detrimentally impact our access to liquidity sources include a decrease in the level of our business activity due to a market downturn in markets in which our loans are concentrated, a change in our financial condition or adverse regulatory action against us. Our ability to borrow could also be impaired by factors that are not specific to us, such as a severe disruption of the financial markets or negative views and expectations about the prospects for the financial services industry as a whole.

If we lost a significant portion of our low-cost deposits, it would negatively impact our liquidity and profitability.

Our profitability depends in part on our success in attracting and retaining a stable base of low-cost deposits. At December 31, 2019, 33.7% of our deposit base was comprised of non-interest bearing deposits, and the average rate on our interest-bearing deposits during 2019 was 0.21%. While we generally do not believe these core deposits are very sensitive to interest rate fluctuations, the competition for these deposits in our markets is strong. If we were to lose a significant portion of our low-cost deposits, it could negatively impact our liquidity and profitability.

We may be the subject of litigation, which could result in legal liability and damage to our business and reputation.

From time to time, we may be subject to claims or legal action from customers, employees or others. Financial institutions like the Company and the Bank are facing a growing number of significant class actions, including those based on the manner of calculation of interest on loans and the assessment of overdraft fees. Future litigation could include claims for substantial compensatory and/or punitive damages or claims for indeterminate amounts of damages. We are also involved from time to time in other reviews, investigations and proceedings (both formal and informal) by governmental and other agencies regarding our business. These matters also could result in adverse judgments, settlements, fines, penalties, injunctions or other relief. Like other large financial institutions, we are also subject to risk from potential employee misconduct, including non-compliance with policies and improper use or disclosure of confidential information.

Our insurance may not cover all claims that may be asserted against us, and any claims asserted against us, regardless of merit or eventual outcome, may harm our reputation. Should the ultimate judgments or settlements in any litigation exceed our insurance coverage, they could have a material adverse effect on our financial condition and results of operations. In addition, we may not be able to obtain appropriate types or levels of insurance in the future, nor may we be able to obtain adequate replacement policies with acceptable terms, if at all.

If we are limited in our ability to originate loans secured by commercial real estate we may face greater risk in our loan portfolio.

Federal banking agencies have issued guidance regarding high concentrations of commercial real estate loans within bank loan portfolios. The guidance requires financial institutions that exceed certain levels of commercial real estate lending compared with their total capital to maintain heightened risk management practices that address the following key elements: board and management oversight and strategic planning, portfolio management, development of underwriting standards, risk assessment and monitoring through market analysis and stress testing, and maintenance of increased capital levels as needed to support the level of commercial real estate lending. If there is any deterioration in our commercial real estate portfolio or if our regulators conclude that we have not implemented appropriate risk management practices, it could adversely affect our business, and could result in the requirement to maintain increased capital levels. Such capital may not be available at that time, and may result in our regulators requiring us to reduce our concentration in commercial real estate loans.

If because of our concentration of commercial real estate loans, or for any other reasons, we are limited in our ability to originate loans secured by commercial real estate, our results of operations may be negatively impacted and we may incur greater risk in our loan portfolio.

The laws and regulations, including the Dodd-Frank Act, applicable to the banking industry could change at any time, and these changes may adversely affect our business and profitability.

We are subject to extensive federal and state regulation. Because government regulation greatly affects the business and financial results of all commercial banks and bank holding companies, our cost of compliance could adversely affect our ability to operate profitably. The increased scope, complexity, and cost of corporate governance, reporting, and disclosure practices are proportionately higher for a company of our size and will affect our profitability more than that of some of our larger competitors. We expect to experience increasing compliance costs related to this supervision and regulation.

Also, the 2016 national election results and new administration have introduced additional uncertainty into future implementation and enforcement of the Dodd-Frank Act and other financial sector regulatory requirements. Such additional regulation and supervision may increase our costs and limit our ability to pursue business opportunities. The effects of any such recently enacted, or proposed, legislation and regulatory programs on us cannot reliably be determined at this time.

The Consumer Financial Protection Bureau (the "CFPB") recently issued "ability-to-repay" and "qualified mortgage" rules that may have a negative impact on our loan origination process and foreclosure proceedings, which could adversely affect our business, operating results and financial condition.

On January 10, 2013, the CFPB issued a final rule to implement the "qualified mortgage" provisions of the Dodd-Frank Act requiring mortgage lenders to consider consumers' ability to repay home loans before extending them credit. The CFPB's "qualified mortgage" rule, which became effective on January 10, 2014, describes certain minimum requirements for lenders making ability-to-repay determinations, but does not dictate that they follow particular underwriting models. Lenders will be presumed to have complied with the ability-to-repay rule if they issue "qualified mortgages," which are generally defined as mortgage loans prohibiting or limiting certain risky features. Loans that do not meet the ability-to-repay standard can be challenged in court by borrowers who default, and the absence of ability-to-repay status can be used against a lender in foreclosure proceedings. Any loans that we make outside of the "qualified mortgage" criteria could expose us to an increased risk of liability and reduce or delay our ability to foreclose upon the underlying property. Any decreases in loan origination volume or increases in compliance and foreclosure costs caused by the rule could negatively affect our business, operating results and financial condition. The CFPB also has adopted a number of additional requirements and issued additional guidance, including with respect to appraisals, escrow accounts and servicing, each of which entails increased compliance costs. In addition, the CFPB likely will continue to make rules relating to consumer protection, and it is difficult to predict which of our products and services will be subject to these rules or how these rules will be implemented.

Compliance with the Dodd-Frank Act has increased our regulatory compliance burdens, may increase our operating costs and may adversely impact our earnings or capital ratios, or both.

Signed into law on July 21, 2010, the Dodd-Frank Act has represented a significant overhaul of many aspects of the regulation of the financial services industry. Among other things, the Dodd-Frank Act created the CFPB, tightened capital standards, imposed clearing and margining requirements on many derivatives activities and generally increased oversight and regulation of financial institutions and financial activities.

In addition to the self-implementing provisions of the statute, the Dodd-Frank Act calls for over 200 administrative rulemakings by numerous federal agencies to implement various parts of the legislation. While many rules have been finalized or issued in proposed form, additional rules have yet to be proposed. It is not possible at this time to predict when all such additional rules will be issued, their final form or requirements, their applicability to the Company or the Bank, or when they will be implemented.

The cost of complying with the new consumer protection regulations and policies could adversely affect our business.

The Dodd-Frank Act created the CFPB, a new regulatory entity with broad powers to supervise and enforce consumer protection laws. The CFPB has extensive rulemaking authority for a wide range of consumer protection laws that apply to banks and other types of lenders, including the authority to prohibit “unfair, deceptive or abusive” acts and practices. It also has examination and enforcement authority over all banks with more than $10 billion in assets. Institutions with less than $10 billion in assets, like the Bank, are examined for compliance with consumer protection laws by their primary bank regulators, but these regulators defer to the CFPB’s rules and interpretations in evaluating a bank’s compliance with consumer protection laws. Therefore, although the CFPB does not directly supervise us, the actions of the CFPB significantly impact our operations.

The CFPB has set forth numerous rules and guidance documents since its inception concerning a wide range of consumer protection laws, many of which are directly applicable to our operations. For example, the CFPB recently imposed new requirements regarding the origination and servicing of residential mortgage loans, limitations on the manner in which loan originators may be compensated, mandatory disclosures on documentation given to borrowers, and an obligation on the part of lenders to verify a borrower’s “ability to repay” a residential mortgage loan before extending credit, among others. The CFPB likely will continue to make rules relating to consumer protection, and it is difficult to predict which of our products and services will be subject to these rules or how these rules will be implemented. However, compliance with CFPB regulations likely will result in additional operating and compliance costs that could have a material adverse effect on our business, consolidated financial condition, results of operations, or cash flows.

We have the ability to borrow from the Federal Home Loan Bank, and there can be no assurance their programs will continue in their current manner.

We have access to funding by the Federal Home Loan Bank of Des Moines for term advances; we also borrow from correspondent banks under our Fed Funds lines of credit from time to time, primarily to test the continuing availability of those lines. The amount loaned to us is generally dependent on the value of the collateral pledged. These lenders could reduce the percentages loaned against various collateral categories, could eliminate their acceptance of certain types of collateral, and could otherwise modify or even terminate their loan programs, particularly to the extent they are required to do so because of capital adequacy or other balance sheet concerns. Any change or termination of the programs under which we borrow from the Federal Home Loan Bank of Des Moines or correspondent banks could have an adverse effect on our liquidity and profitability.

Our results of operations may be adversely affected by other-than-temporary impairment charges relating to our securities portfolio.

We may be required to record future impairment charges on our securities, including our stock in the Federal Home Loan Bank of Des Moines, if they suffer declines in value that we consider other-than-temporary. Numerous factors, including the lack of liquidity for re-sale of certain securities, the absence of reliable pricing information for some securities, adverse changes in the business climate, adverse regulatory actions or unanticipated changes in the competitive environment, could have a negative effect on our securities portfolio in future periods. Significant impairment charges could also negatively impact our regulatory capital ratios and result in the Bank not being classified as “well-capitalized” for regulatory purposes.

We may need to raise additional capital in the future, and such capital may not be available when needed or at all.

We may need to raise additional capital in the future to provide us with sufficient capital resources and liquidity to meet regulatory requirements, our commitments or our business needs. Our ability to raise additional capital, if needed, will depend, among other things, on conditions in the capital markets at that time, which are outside of our control, and our financial performance. The loss of confidence in financial institutions may increase our cost of funding and limit our access to some of our customary funding sources, including, but not limited to, inter-bank borrowings and borrowings from the discount window of the Federal Reserve.

We cannot provide assurances that such capital will be available to us on acceptable terms or at all. Any occurrence that may limit our access to the capital markets, such as a decline in the confidence of debt purchasers, depositors of the Bank or counterparties participating in the capital markets, may adversely affect our capital costs and our ability to raise capital and, in turn, our liquidity.

We must effectively manage our growth strategy.

As part of our general growth strategy, we may expand into additional communities or attempt to strengthen our position in our current markets by opening new offices. To the extent that we are able to open additional offices, we are likely to temporarily experience the effects of higher operating expenses relative to operating income from the new operations for a period of time, which may have an adverse effect on our levels of reported net income, return on average equity and return on average assets. Our current growth strategies involve internal growth from our current offices and the addition of new offices over time, so that the additional overhead expenses associated with recent openings are absorbed prior to opening other new offices.

We have a nominal amount of deferred tax asset and cannot assure that it will be fully realized.

Deferred tax assets and liabilities are the expected future tax amounts for the temporary differences between the carrying amounts and tax basis of assets and liabilities computed using enacted tax rates. If we determine that we will not achieve sufficient future taxable income to realize our net deferred tax asset, we are required under generally accepted accounting principles to establish a full or partial valuation allowance. If we determine that a valuation allowance is necessary, we are required to incur a charge to operations. We regularly assess available positive and negative evidence to determine whether it is more likely than not that our net deferred tax asset will be realized. Realization of a deferred tax asset requires us to apply significant judgment and is inherently speculative because it requires estimates that cannot be made with certainty. At December 31, 2019, we had a net deferred tax asset of $7.5 million. For the year ended December 31, 2019, we established a partial valuation allowance of $1.8 million to reduce the net deferred tax asset of $9.3 million because, in management’s opinion, it is more likely than not that only the remaining $7.5 million will be realized. If we were to determine at some point in the future that we will not achieve sufficient future taxable income to realize our net deferred tax asset, we would be required, under generally accepted accounting principles, to establish a full or increase any partial valuation allowance, which would require us to incur a charge to operations for the period in which the determination was made. The deferred tax asset valuation allowance at December 31, 2019, was decreased by $373 thousand, as compared to an increase of $215 million at December 31, 2018.

We face strong competition from financial service companies and other companies that offer banking services.

We face substantial competition in all phases of our operations from a variety of different competitors. Our competitors, including larger commercial banks, community banks, savings and loan associations, credit unions, consumer finance companies, insurance companies, brokers, investment advisors and other financial institutions, compete with the lending and deposit-gathering services we offer. Increased competition in our markets may result in reduced loans and deposits.

Many of these competing institutions have much greater financial and marketing resources than we have. Due to their size, many competitors can achieve larger economies of scale in a broader range of products and services than we can. If we are unable to offer competitively priced products and services, our business may be negatively affected.

Some of the financial services organizations with which we compete are not subject to the same degree of regulation as is imposed on bank holding companies and federally insured financial institutions, and are not subject to increased supervisory oversight arising from regulatory examinations. As a result, these non-bank competitors have certain advantages over us in accessing funding and in providing various services. The banking business in our primary market areas is very competitive, and the level of competition facing us may increase further, which may limit our asset growth and financial results.

In the future, the Bank and/or the Company may become subject to supervisory actions and/or enhanced regulation that could have a material adverse effect on our business, operating flexibility, financial condition, the value of our common stock and our ability to pay dividends to our stockholders.

Under federal, state and local laws and regulations pertaining to the safety and soundness of insured depository institutions, various state or local regulators (for non-federally chartered banks), the Federal Reserve Board (for bank holding companies and member banks), the local financial industry regulators of the various jurisdictions in which the Bank operates and, separately, the FDIC as the insurer of bank deposits, each have the authority to compel or restrict certain activities on our part if they determine that we have insufficient capital or are otherwise operating in a manner that may be deemed to be inconsistent with safe and sound banking practices. Under their respective authority, our bank regulators can require us to enter into informal or formal enforcement orders, including board resolutions, memoranda of understanding, written agreements, and consent or cease and desist orders, pursuant to which we may be required to take identified corrective actions to address cited concerns or to refrain from taking certain actions. Neither the Bank nor the Company is currently operating under any regulatory enforcement orders.

Technology is continually changing and we must effectively implement new technologies.

The financial services industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. In addition to better serving customers, the effective use of technology increases efficiency and enables us to reduce costs. Our future success will depend in part upon our ability to address the needs of our customers by using technology to provide products and services that will satisfy their demands for convenience, as well as to create additional efficiencies in our operations as we continue to grow and expand our geographic and product markets. In order to anticipate and develop new technology, we employ a qualified staff of internal information system specialists and consider this area a core part of our business. We do not develop our own software products, but have been able to respond to technological changes in a timely manner through association with leading technology vendors. We must continue to make substantial investments in technology, which may affect our results of operations. If we are unable to make such investments, or we are unable to respond to technological changes in a timely manner, our operating costs may increase, which could adversely affect our operating results.

System failure or breaches of our network security could subject us to increased operating costs as well as litigation and other potential liabilities.

The computer systems and network infrastructure we use could be vulnerable to unforeseen problems. Our operations are dependent upon our ability to protect our computer equipment against damage from physical theft, fire, power loss, telecommunications failure or a similar catastrophic event, as well as from security breaches, denial of service attacks, viruses, worms and other disruptive problems caused by malicious parties. Any damage or failure that causes an interruption in our operations could have a material adverse effect on our financial condition and results of operations. Computer break-ins and other disruptions could also jeopardize the security of information stored in and transmitted through our computer systems and network infrastructure, which may result in significant liability to us and may cause existing and potential customers to refrain from doing business with us. We employ external auditors to conduct auditing and testing for weaknesses in our systems, controls, firewalls and encryption to reduce the likelihood of any security failures or breaches, as well as both internal and external monitoring systems to detect and report any attempt to overcome our electronic defenses. Although we, with the help of third-party service providers and auditors, intend to continue to implement effective security technology and establish operational procedures to prevent such damage, there can be no assurance that these security measures will ultimately be successful. In addition, advances in computer capabilities, new discoveries in the field of cryptography or other developments could result in a compromise or breach of the algorithms we and our third-party service providers use to encrypt and protect customer transaction data. A failure of such security measures would present a reputational risk, and could have a material adverse effect on our financial condition and results of operations.

Breaches of third parties' network security could subject us to increased operating costs and other liabilities.

In recent years, there have been numerous highly publicized breaches of customer databases maintained by both public and private entities, often compromising personally identifiable information. These breaches increase the risk that compromised information may be used to fraudulently obtain financial services. The Bank has established systems to mitigate the possibility that some compromised information could be used fraudulently to open deposit and/or loan accounts. Despite all reasonable efforts, though, we are unable to be absolutely certain that the risk of that form of fraud is entirely eliminated.

Further, some of these third party data breaches have compromised credit card information, creating an opportunity to defraud the Bank and its credit card customers by initiating fraudulent charges using the compromised card information. Under current law, the Bank retains potential liabilities associated with those fraudulent charges. Also, when it is known that a credit card has been compromised, the Bank incurs costs in replacing the card. As a result, a third-party network security breach could have a material adverse effect on our financial condition and the results of our operations.

Managing operational risk is important to attracting and maintaining customers, investors and employees.

Operational risk represents the risk of loss resulting from our operations, including but not limited to, the risk of fraud by employees or persons outside the Bank, the execution of unauthorized transactions by employees, transaction processing errors and breaches of the internal control system, and failure to effectively meet compliance requirements. This risk of loss also includes the potential legal actions that could arise as a result of an operational deficiency or as a result of noncompliance with applicable regulatory standards, adverse business decisions or their implementation, and customer attrition due to potential negative publicity. Operational risk is inherent in all business activities, and the management of this risk is important to the achievement of our business objectives. In the event of a breakdown in our internal control system, improper operation of systems or improper employee actions, we could suffer financial loss, face regulatory action and suffer damage to our reputation. We have a stringent code of ethics and attendant procedures in place to protect our reputation and promote ethical conduct, but these policies and procedures might not be fully effective. Negative publicity regarding our business, employees, or customers, with or without merit, may result in the loss of customers, investors and employees, costly litigation, a decline in revenues and increased regulatory oversight.

Severe weather, natural disasters, acts of war or terrorism, and other external events could significantly impact our business.

Severe weather, natural disasters, acts of war or terrorism, and other adverse external events or conditions have the potential to significantly impact our ability to conduct business. Such events or conditions could affect the stability of our deposit base, impair the ability of borrowers to repay outstanding loans, impair the value of collateral securing loans, cause significant property damage, result in loss of revenue and/or cause us to incur additional expenses. For example, our primary market areas in Guam and the Commonwealth of the Northern Mariana Islands (the "CNMI") are subject to typhoons, earthquakes and wildland fires, and our California region is subject to earthquakes and wildland fires. All of the islands in our market are at risk from more frequent and more intense storms, coastal flooding and coastal erosion related to climate change. Operations in our market could be disrupted by both the evacuation of large portions of the population as well as damage and/or lack of access to our banking and operational facilities. While we have experienced severe weather and strong earthquakes in the past and resumed our operations promptly, a recurrence of these, along with acts of war, terrorism or other adverse external events or conditions, may occur in the future. Although management has established a business continuity plan, disaster recovery policies and corresponding procedures, the occurrence of any such event could have a material adverse effect on our business, which, in turn, could have a material adverse effect on our financial condition and results of operations.

Epidemics, including pandemics, present a risk to the island markets that we serve and may cause unpredictable effects on their economies and performance, and the market value of our common stock.

With the advent of globalization and the substantial expansion of international transportation, combined with regional and worldwide climate changes, the increase in the number of bacterial and viral diseases that are widely and quickly distributed may affect our profitability in one or more of our market areas. In an island environment, an epidemic has effectively the same result as a pandemic and may potentially have greater or lesser effects on economic conditions, whether locally or throughout our network. We may decide to defer payments, extend maturities or otherwise modify the terms of existing commercial and/or consumer loans in order to protect the value of our loan portfolio, although there is the possibility that we may experience some loan losses. Depending on the severity of those effects, a decline in the market price of our common stock could occur.

In December 2019, a novel strain of coronavirus (COVID-19) emerged in Wuhan, Hubei Province, China. While initially the outbreak was largely concentrated in China and caused significant disruptions to its economy, it has now spread to several other countries and infections have been reported globally. The World Health Organization declared a global emergency on January 30, 2020. The extent to which the coronavirus impacts our operations will depend on future developments, which are highly uncertain and cannot be predicted with confidence, including the duration of the outbreak, new information which may emerge concerning the severity of the coronavirus and the actions to contain the coronavirus or treat its impact, among others. In particular, the continued spread of the coronavirus globally could adversely impact our operations and could have an adverse impact on our business and our financial results.

Uncertain geopolitical conditions could have a material adverse effect on our business and the markets that we serve, which could cause the market price of our common stock to decline.

Our business is subject to geopolitical conditions in the western Pacific, including concerns over North Korea's nuclear weapons program and China's expanded military operations in the South and East China Seas. This has resulted in increased uncertainty regarding both China's and North Korea's actions and the potential responses of the United States. In addition, after several years of substantial Chinese investment in tourism activities in two of the islands in the Bank's market, both investments and the arrival of tourists from China into those islands were suddenly curtailed, more or less disrupting both of those economies. Any of these conditions could result in a decline in the market price of shares of our common stock.

Risks Related to Our Securities

The price of our common stock may fluctuate significantly, and this may make it difficult for stockholders to resell shares of common stock at times or at prices they find attractive.

The Company common stock is traded in the Over-the-Counter market under the symbol "BKGM." The trading volume has historically been substantially less than that of larger financial services companies. This may make it difficult for stockholders to resell shares of common stock at times or at prices they find attractive. Stock price volatility may also make it more difficult to sell common stock quickly and at attractive prices.

ITEM 1B. Unresolved Staff Comments

None.

ITEM 2. Properties

Our properties consist primarily of leased office facilities for our branch offices. Our headquarters facility, which we own, consists of 74,240 square feet in Hagåtña, Guam. We also own the buildings of our Santa Cruz branch in Guam, our Garapan branch in Saipan and the Rota branch in the CNMI, which comprise 47,292 square feet in total. These branch buildings are situated on leased land. We believe our facilities are in excellent condition and suitable for the conduct of our business. On January 15, 2020 the FDIC notified the Bank that they have no objections to the closure of the Tumon and Malesso branches in Guam effective April 3, 2020.

For additional information on operating leases and rent expense, see Note 16 to the Consolidated Financial Statements.

ITEM 3. Legal Proceedings

Neither the Company nor the Bank is involved in any legal proceedings other than those occurring on a routine basis in the ordinary course of business. The majority of such proceedings have been initiated by the Bank in the process of collecting delinquent loans. Such routine legal proceedings, in the aggregate, are believed by management to be immaterial to the financial condition, results of operations and cash flows of the Company as of December 31, 2019.

ITEM 4. Mine Safety Disclosures

None.

PART II

ITEM 5. Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Market and Dividend Information

The Company’s common stock is quoted on the OTC Bulletin Board under the symbol “BKGM.” Transactions of the Company’s common stock through private negotiated sales are also facilitated with the assistance of the Bank’s Trust Department. Management is not aware of any securities dealers which actively make a market in the Company’s common stock. No assurance can be given that an active trading market will be sustained for the common stock at any time in the future. The following table sets forth the high and low sale price for the common stock for the periods indicated, along with cash dividend payments for each of the quarters presented. The stock prices in the table are based upon information provided by the Bank’s Trust Department, and are derived from private sales executed through the Bank’s Trust Department and prices quoted through the OTC Bulletin Board.

	Stock Price					
	High		Low		Dividend Per Share	
Year ended December 31, 2019						
Fourth Quarter	$	11.90	$	9.75	$	0.100
Third Quarter	$	11.80	$	9.75	$	0.100
Second Quarter	$	12.51	$	10.00	$	0.100
First Quarter	$	13.20	$	9.75	$	0.100
Year ended December 31, 2018						
Fourth Quarter	$	11.99	$	10.00	$	0.100
Third Quarter	$	12.00	$	10.00	$	0.100
Second Quarter	$	12.00	$	9.00	$	0.100
First Quarter	$	12.25	$	7.00	$	0.100

As of March 19, 2020, there were approximately 4,496 holders of record of common stock. There are no other classes of common equity.

Dividend Policy

At its discretion, the Board of Directors of the Company declares dividends to its stockholders on a quarterly basis. The Company declared and paid dividends of $0.10 per share to stockholders as of a declaration date for each share of common stock outstanding in each of the eight calendar quarters ended December 31, 2019.

The amount of future dividends will depend upon our earnings, financial condition, capital requirements and other factors, and will be determined by our Board of Directors on a quarterly basis. It is the policy of the Federal Reserve Board that bank holding companies generally pay dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the organization’s expected future needs and financial condition. It is also the policy of the Federal Reserve Board that bank holding companies not maintain dividend levels that undermine the holding company’s ability to be a source of strength to its banking subsidiaries. Additionally, in consideration of the current financial and economic environment, the Federal Reserve Board has indicated that bank holding companies should carefully review their dividend policy and has discouraged payment ratios that are at maximum allowable levels unless both asset quality and capital are very strong. Under the federal Prompt Corrective Action regulations, the Federal Reserve Board may prohibit a bank holding company from paying any dividends if the holding company is undercapitalized, and the FDIC may prohibit a non-member bank from paying any dividends if the bank is undercapitalized.

As a holding company, our ability to pay cash dividends is affected by the ability of our bank subsidiary, the Bank, to pay cash dividends. The ability of the Bank (and our ability) to pay cash dividends in the future and the amount of any such cash dividends is and could in the future be further influenced by bank regulatory requirements and approvals and capital guidelines. Funds for payment of any cash dividends by the Company would be obtained from its investments as well as dividends from the Bank. The decision whether to pay dividends will be made by our Board of Directors in light of conditions then existing, including factors such as our results of operations, financial condition, business conditions, regulatory capital requirements and covenants under any applicable contractual arrangements, including agreements with regulatory authorities.

The Company also has $9.8 million in preferred stock outstanding for which it paid $547 thousand in dividends in 2019.

Securities Authorized for Issuance Under Equity Compensation Plans

Stock Purchase Plan

The Bank's 2011 Employee Stock Purchase Plan (the "2011 Plan") was adopted by the Bank's Board of Directors and approved by the Bank's Stockholders on May 2, 2011, to replace the Bank's 2001 Non-Statutory Stock Option Plan. This plan was subsequently adopted by the Company. The 2011 Plan is open to all employees of the Company and its subsidiaries who have met certain eligibility requirements.

Under the 2011 Plan, as amended and restated as of July 1, 2012, eligible employees can purchase, through payroll deductions, shares of common stock at a discount. The right to purchase stock is granted to eligible employees during a quarterly offer period 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.

	At December 31, 2019		
	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Plan category	**(a)**	**(b)**	**(c)**
Equity compensation plans approved by security holders	-	$ 9.08	1,372,055
Equity compensation plans not approved by security holders	-	$ -	-
Total	-	$ 9.08	1,372,055

ITEM 6. Selected Financial Data

Information requested by this Item is not applicable as we are electing scaled disclosure requirements available to Smaller Reporting Companies with respect to this Item.

ITEM 7. 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 Annual Report.

Executive Summary

This summary is intended to identify the most important matters on which management focuses when it evaluates the financial condition and performance of the Bank. When evaluating financial condition and performance, management looks at certain key metrics and measures. The Bank's evaluation includes comparisons with peer group financial institutions and its own performance objectives established in internal planning processes.

The primary activity of the Bank is commercial banking, as it has been since the Bank opened in Guam in 1972. The Company's operations are located entirely in the U.S. territories, the U.S.-affiliated nations of the western Pacific, and in the San Francisco Bay area of California. The largest community in the Bank's western Pacific market is Guam, followed by the Commonwealth of the Northern Mariana Islands. The market includes a number of transportation-, travel- and tourism-related companies in the region, as well as substantial U.S. Department of Defense and other U.S. federal government activities in Guam. The Company's customers are primarily transnational corporations, governments, closely-held businesses and individuals.

During 2019, there were five significant factors that impacted the Company's financial condition and operations:

- Over the course of the year, tourist arrivals continued to increase in Guam and other islands in the region, excepting the Republic of Palau and the Commonwealth of the Northern Mariana Islands. In Guam, the number of visitors reached its highest level in history, at 1.67 million. An increase of 21.6% in Japanese arrivals was the primary source of this growth, while arrivals from South Korea, although holding relatively stable, with a 0.9% increase, still accounted for 45.2% of all arrivals compared to arrivals from Japan which accounted for 38.9%. The continuing growth in Guam's tourism industry led to modest improvements in payroll employment and other aspects of the regional economy, enhancing the Bank's business.
- The military buildup continues, and substantial funding is being provided for the relocation of U.S. Marines from Okinawa to Guam. Several contracts, totaling hundreds of millions of dollars, were executed during 2018 and 2019, and additional years of construction and related activity are expected to bring increased investment and income to Guam. There is also a much more modest level of activity in the CNMI, which has been providing help as that economy recovers from highly destructive windstorms. Once completed, the activities that these projects support will provide a sustained contribution to both economies.
- Many of Guam's resident construction workers have been absorbed by military construction projects, and the disinclination of the U.S. Department of Homeland Security to issue H-2B visas to temporary foreign construction workers has brought work on civilian projects nearly to a standstill. The resulting difficulty building new structures in the civilian community as existing structures age and are taken out of service has distorted Guam's real estate market, causing real estate prices to rise. In addition, many investment opportunities in the private sector that would have brought outside funds into the local economy have been lost, slowing the pace of Guam's economic growth. Early in 2019, the Department of Homeland Security implemented a one-year moratorium on bring temporary workers from the Philippines, historically the primary source of temporary construction workers for Guam and the Northern Mariana Islands, into the United States.
- The Commonwealth of the Northern Mariana Islands experienced two typhoons during 2018, and sustained substantial damage to housing, commercial buildings and public facilities. Bank of Guam offered the temporary suspension of loan payments in order to help the CNMI recover. Repairs to reconstruction of the islands' infrastructure and superstructure continue through the date of this filing. The reconstruction efforts provided an opportunity for the Bank to expand its loan portfolio there by 29.8%.
- The sustained strength of the economy in the San Francisco Bay area provided continuing opportunities to expand the Bank's business there, leading to an increase of 6.3% in the California region's loan portfolio, supplementing the growth in loans in the Commonwealth of the Northern Mariana Islands, 12.0% in The Freely Associated States of Micronesia, and 1.0% in the Guam market supporting an overall growth of 5.4% in the total loan portfolio. The 3.2% increase in the Bank's asset base reflected an 87.3% rise in other assets, primarily due to the adoption of ASU 2016-02 Leases on January 1, 2019, offset by a 4.9% reduction of our investment portfolio, and a 15.0% reduction in our cash and cash equivalents and restricted cash. The 2.6% increase in total liabilities during the year, including a 0.1% increase in total deposits, was supplemented by the 10.7% increase in our stockholders' equity.

For the year ended December 31, 2019, net income attributable to common stockholders was $15.6 million, or $1.62 per basic and diluted common share. For the year ended December 31, 2018, net income was $12.3 million, or $1.28 per basic and diluted common share. For the year ended December 31, 2017, net income was $8.0 million, or $0.86 per basic and diluted common share.

The returns on average assets and average equity for the year ended December 31, 2019, were 0.83% and 10.23%, respectively, compared to 0.67% and 8.86%, respectively, for 2018. The equity to asset ratios for the same periods were 8.41% and 7.84%, respectively, while the dividend payout ratios were 27.30% and 34.27%, respectively. As provided in the 2017 Form 10-K that was filed with the Securities and Exchange Commission on June 29, 2018, the returns on average assets and average equity for the year ended, were 0.44% and 6.24%, respectively. For that year, the equity to assets ratio and dividend payout ratio were 7.03% and 49.98%, respectively.

The following are major factors that impacted the Company's results of operations:

- Net interest income increased 2.8% to $90.4 million for the year ended December 31, 2019, from $87.9 million for the year ended December 31, 2018, due to a $2.9 million increase in interest income, offset by an increase of $374 thousand in interest expense.
- The net interest margin increased 14 basis points to 4.93% for the year ended December 31, 2019, compared with 4.79% for the year ended December 31, 2018. The increase in the net interest margin for 2019 compared to 2018 was primarily due to a 25 basis point increase in the average yield on our securities portfolio and a 53 basis point increase in the average yield on our deposits with other financial institutions; the average rates that we paid on deposits increased by 0.4 basis points.
- The provision for loan losses was $9.8 million for the year ended December 31, 2019, $3.1 million lower than the provision during 2018. The 2019 provision was decreased to reflect the decreasing consumer and residential mortgage portfolios, the decrease in consumer loan charge offs, and no additional provisions were needed for the two commercial borrowers in bankruptcy. The provision is deemed by management to provide a sufficient allowance for loan losses due to the higher risk to the overall loan portfolio and to net losses of $5.7 million during the year, including $6 thousand assigned to the reserve for off-balance sheet risk.
- Non-interest income was $17.7 million for the year ended December 31, 2019, $2.0 million more than the $15.7 million for the year ended December 31, 2018. The increase in non-interest income in 2019 compared to 2018 were primarily due to the $347 thousand in net investment securities gains in 2019 compared to the $593 thousand in net losses in 2018, the $606 thousand increase in net cardholder income. The gain on the sale of investment securities occurred due to a need to replenish our liquidity after large withdrawals and funds transfers during the third quarter.
- Non-interest expense was $76.5 million for the year ended December 31, 2019, compared to $75.0 million for the year ended December 31, 2018. The increase of 2.0%, primarily due to an increase of $1.2 million in equipment and depreciation expense, an additional $1.1 million in occupancy expense, and a rise of $541 thousand in other real estate owned, partially offset by a $565 thousand decrease in telecommunications expense, a reduction of $441 thousand in the FDIC assessment, and a fall of $312 thousand in salaries and employee benefits.
- The 25.8% increase of net after tax income to $16.2 million in 2019 compared to $12.8 million 2018 was due to the $2.5 million increase in net interest income, the $2.0 million increase in non-interest income, and a reduction of $3.1 million in our provision for loan losses, partially offset by the $1.5 million increase in non-interest expense and the $2.7 million increase in income tax expense.

The following are important factors in understanding our current financial condition and liquidity position:

- Cash, interest-bearing deposits in other banks, and investment securities available-for-sale collectively decreased by $27.3 million (5.1%), to $508.8 million, at December 31, 2019, from $536.1 million at December 31, 2018. This decrease in liquid assets is due to a decrease of $28.0 million in interest bearing deposits in other banks, a fall of $3.9 million in securities available-for-sale, partially offset by a $4.6 million increase in cash.
- Total assets increased by $61.4 million or 3.2%, from $1.89 billion at December 31, 2018, to $1.95 billion at December 31, 2019. This increase was composed of a $63.1 million or 5.2% increase in net loans (net of deferred fees and the allowance for loan losses) to $1.28 billion at December 31, 2019, compared to $1.21 billion at December 31, 2018, and a $38.9 million increase in other assets, partially offset by a decrease of $23.4 million in cash and cash equivalents to $131.7 million at December 31, 2019 compared to $155.1 million at December 31, 2018, and a decrease in investment securities by $22.0 million. The increase in loans was primarily attributable to an increase of $101.2 million in gross commercial loans, to $945.5 million at the end of 2019 compared to $844.4 million a year earlier, partially offset by a decrease of $33.7 million in gross consumer loans, to $360.5 million at December 31, 2019, from $394.2 million at December 31, 2018, and the increase in other assets during the period is largely attributed to the adoption of ASU 2016-02 – "Leases" on January 1, 2019, in which the Company recognized right-of-use assets of $32.8 million upon adoption, and had a remaining balance of $29.9 million at December 31, 2019. The contra to the increase of total assets, total liabilities increased by $45.4 million, to $1.79 billion at December 31, 2019, based upon an increase of $1.1 million in total deposits

from the previous year end, coupled by an increase of $14.7 million in subordinated debt that the Company issued on June 27, 2019, and a $29.6 million increase in other liabilities. The increase in other liabilities is the result of adoption of ASU 2016-02 – “Leases”, in which the Company recognized lease liabilities of $32.7 million, and had a remaining balance of $30.2 million at December 31, 2019. Enhancing the effect of the increase in total liabilities, total stockholders’ equity increased by $15.9 million, composed of the $12.2 million increase in retained earnings, a $3.4 million improvement in accumulated other comprehensive loss, and a $264 thousand increase in additional paid-in common stock.

- Classified assets increased to $77.7 million at December 31, 2019, compared to $74.5 million at December 31, 2018.
- The allowance for loan losses at December 31, 2019, was $27.9 million, or 2.13% of total gross loans. The allowance for loan losses at December 31, 2018, was $23.8 million, or 1.92% of total gross loans.
- Nonperforming loans increased by $4.0 million to $11.0 million, or 0.84% of total gross loans, at December 31, 2019, from $7.1 million, or 0.57% of total gross loans, at December 31, 2018.
- Net loan charge-offs were $5.7 million during the year ended December 31, 2019, as compared to the $6.4 million in net charge-offs for the year ended December 31, 2018.
- The ratio of noncore funding of $14.2 million (which consists of $250,000 and over time deposits plus short-term borrowings) to total assets was 0.73% at December 31, 2019, compared to $14.2 million, or 0.75% of total assets, at December 31, 2018.
- The loan-to-deposit ratio increased to 75.5% at December 31, 2019, as compared to 71.6% at December 31, 2018, due to total gross loan growth of $67.4 million and the $1.1 million nominal growth in deposits.
- There are no conditions or events since the notification that management believes have changed the Bank’s category. The Company’s capital ratios significantly exceed regulatory requirements for a well-capitalized financial institution. The leverage ratio of the Company was 8.42%, with a Tier 1 risk-based capital ratio of 12.06%, a total risk-based capital ratio of 14.42%, and a common equity Tier 1 risk-based capital ratio of 11.34% at December 31, 2019, compared to the leverage ratio of 7.99%, with a Tier 1 risk-based capital ratio of 12.40%, a total risk-based capital ratio of 13.66% and a common equity Tier 1 risk-based capital ratio of 11.61% at December 31, 2018. The changes in our capital ratios from December 31, 2018, to December 31, 2019, were due to the retention of $12.2 million in earnings during 2019.

Deposits

The composition and cost of the Bank’s deposit base are important in analyzing the Bank’s net interest margin and balance sheet liquidity characteristics. The Bank’s depositors are generally located in its primary market area. Depending on loan demand and other funding requirements, the Bank also attracts deposits through its interest rate pricing. The Bank monitors all deposits that may be sensitive to interest rate changes to help ensure that liquidity risk does not become excessive due to deposit migration. Deposits at December 31, 2019, were $1.730 billion, compared to $1.729 billion at December 31, 2018. The 0.1% increase was primarily due to the rise of $65.9 million, or 7.32%, primarily in commercial and government in deposits in Guam, offset by reductions of $45.4 million (13.5%) in the Commonwealth of the Northern Mariana Islands, primarily in government deposits, $19.2 million (4.3%) in the Freely Associated States of Micronesia, primarily due to the disbursement of funds from one large commercial depositor, and $0.3 million (0.5%) in the Bank’s deposits in the California region.

The Bank does not currently accept brokered deposits because it already maintains ample liquidity.

Liquidity

Our liquidity position refers to our ability to maintain cash flows sufficient to fund operations and to meet obligations and other commitments in a timely fashion. We believe that the Bank’s liquidity position is more than sufficient to meet our operating expenses, borrowing needs and other obligations for 2020, and management has tested and determined that, even under severely stressed scenarios, the Bank’s liquidity will be more than adequate to meet our requirements. At December 31, 2019, our liquidity decreased by $27.3 million, 5.1% of total cash and cash equivalents and available-for-sale investment securities totaling $508.8 million compared to $536.1 million at December 31, 2018. Once the increases in our loan portfolio and other assets were accommodated, the marginal increase in our deposit liabilities and smaller increase in our equity were channeled into a decrease in cash and cash equivalents, and our available-for-sale investment securities. At December 31, 2019, we had $131.7 million in cash and cash equivalents and approximately $168.5 million in available borrowing capacity from various sources, including the Federal Home Loan Bank (“FHLB”), the Federal Reserve Bank of San Francisco (“FRB”), and Federal Funds facilities with several financial institutions. The Bank also had approximately $127.6 million in unpledged securities available at December 31, 2019. Our loan-to-deposit ratio increased to 75.5% at December 31, 2019, compared to 71.6% at December 31, 2018, as our gross loans increased by 5.4% and our deposits increased marginally by 0.1%.

Lending

Our loans originate almost entirely through the branch offices located in our primary market. As the Bank approached a saturation point in our island service area, we expanded our activities in California through our branch in San Francisco. The total loan portfolio remains well diversified with commercial and industrial loans accounting for 21.6% and commercial real estate loans accounting for 45.3% of the total loan portfolio at December 31, 2019. Construction loans rose from 3.2% of the portfolio at December 31, 2018, to 5.4% at December 31, 2019. Residential mortgages and other consumer-related loans accounted for the remaining 27.6% of total loans at December 31, 2019. The increase in gross loans during 2019 compared to 2018 was primarily due to an increase of $101.2 million, or 12.0%, in our commercial loan portfolio, partially offset by a $33.7 million, or 8.6%, decrease in consumer loans. The Bank also had a decrease of $0.1 thousand in loans sold to the Federal Home Loan Mortgage Corporation ("Freddie Mac") from $189.6 million at December 31, 2018, to $189.5 million at December 31, 2019, but these loans are off-book, except for the value of the associated mortgage servicing rights. The Bank exercises careful selectivity with respect to the types of loans it chooses to originate.

Net Interest Income

The management of interest income and expense is fundamental to the performance of the Company and the Bank. Net interest income, the difference between interest income and interest expense, is the largest component of the Bank's total revenue. Management closely monitors both total net interest income and the net interest margin (net interest income divided by average earning assets).

The Bank, through its asset and liability management policies and practices, as overseen by its Asset and Liability Committee, seeks to maximize net interest income without exposing itself to an excessive level of interest rate risk. Interest rate risk is managed by monitoring the pricing, maturity and repricing options of all classes of interest-bearing assets and liabilities. This is discussed in more detail under Liquidity and Asset/Liability Management. In addition, as the market allows, we take measures and initiatives to improve our net interest margin, including increasing loan rates, maintaining interest rate floors on floating rate loans, reducing nonperforming assets, managing deposit interest rates and reducing higher-cost deposits.

After several years of historically low rates the Federal Reserve increased the target Federal Funds Rate by 25 basis points four times during 2018, on March 21, June 13, September 26 and December 19, ending in a target range from 2.25% to 2.50%. In 2019, the target Federal Funds Rate was cut three times on July 31, September 18, and October 30, ending the target range from 1.50% to 1.75%. The decrease in short-term rates did not significantly affect the rates applicable to the Bank's floating rate loans. Despite the decrease in short-term interest rates, the overall cost of interest-bearing deposits, which represent the Bank's primary funding source, increased by .04% by the end of 2019, primarily due to issuance of subordinated debt on June 27, 2019. The increase in the level of short-term investments and investment securities has helped the Bank to increase its net interest margin, from 4.79% in 2018 to 4.93% in 2019.

Management of Credit Risk

We continue to proactively identify, quantify and manage our problem loans. Early identification of problem loans and potential future losses helps enable us to resolve credit issues with potentially less risk and lower ultimate losses. We maintain an allowance for loan losses in an amount that we believe is adequate to absorb probable and projected incurred losses in the portfolio. While we strive to carefully monitor and manage credit quality and to identify loans that may be deteriorating, circumstances can change at any time that may result in future losses for loans included in the portfolio, that as of the date of the financial statements have not yet been identified as potential problem loans. Through established credit practices, we adjust the allowance for loan losses accordingly. However, because future events are uncertain, there may be loans that deteriorate, some of which could occur in an accelerated time frame. As a result, future additions to the allowance may be necessary. Because the loan portfolio contains a number of commercial loans, commercial real estate and construction loans with relatively large balances, deterioration in the credit quality of one or more of these loans may require a significant increase to the allowance for loan losses. Future additions to the allowance may also be required based on changes in the financial condition of borrowers, such as have resulted due to changing economic conditions. Additionally, federal and local banking regulators throughout our market area, as an integral part of their supervisory function, periodically review our allowance for loan losses. These regulatory agencies may require us to recognize further loan loss provisions or charge-offs based upon their judgments, which may be different from ours. Any increase in the allowance for loan losses may have a material adverse effect on our financial condition and results of operation.

We also maintain a reserve against potential credit risks associated with our unfunded off-balance sheet loan commitments.

Further discussion of the management of credit risk appears under "*Provision for Loan Losses*" and "*Allowance for Loan Losses*".

Capital Management

As part of its asset and liability management process, the Company continually assesses its capital position to take into consideration growth, expected earnings, risk profile and potential corporate activities that it may choose to pursue.

During the past several years, the Bank's principal source of increases in capital has been retained earnings, supplemented by stock purchases through our Employee Stock Purchase Plan, and issuances of common and preferred stock. See Note 14 of *Notes to Consolidated Financial Statements* in Item 15 of this Annual Report for a description of the Employee Stock Purchase Plan. Since the formation of the Company in 2011, though, the Bank's assets have grown by 77.0%, prompting the Bank to seek additional sources of capital. Those more traditional sources of additional capital are finally catching up, having increased by 85.1% during the same period. A portion of the increase in capital was derived from the sale of additional common and preferred stock and the issuance of subordinated debt.

During the fourth quarter of 2017 and the first quarter of 2018, the Company issued an additional $4.2 million in common stock in an SEC-registered public offering at a purchase price of $12.25 per common share.

A portion of the proceeds from these offerings was used to retire subordinated debt, while the remainder will allow the Company to support the continued organic growth of its banking subsidiary in its existing market areas and will enable us to further serve the needs of individuals and businesses in those markets.

Results of Operations

The Bank earns income from two primary sources. The first is net interest income, which is interest income generated by earning assets less a provision for loan losses and interest expense on interest-bearing liabilities. The second is non-interest income, which primarily consists of service charges and fees, income from merchants for processing credit and debit card transactions, non-interest income from holders of the Bank's credit cards, trustee fees and net investment securities gains. The majority of the Company's non-interest expenses are operating costs that relate to providing a full range of banking services to our customers.

Distribution, Rate and Yield

The following Distribution, Rate and Yield table presents the average amounts outstanding during 2019 and 2018 for the major categories of the Company's balance sheet, the average interest rates earned or paid thereon, and the resulting net interest margin on average interest earning assets for the periods indicated. Average balances are based on monthly averages.

	Years Ended December 31,					
	2019			2018		
	Average Balance	Interest Earned/Paid	Average Yield/Rate	Average Balance	Interest Earned/Paid	Average Yield/Rate
Interest earning assets:						
Short term investments[1]	$ 123,371	$ 2,218	1.80%	$ 94,878	$ 1,202	1.27%
Investment Securities[2]	443,990	9,674	2.18%	503,180	9,682	1.92%
Loans[3]	1,267,311	81,013	6.39%	1,239,065	79,158	6.39%
Total earning assets	1,834,672	92,905	5.06%	1,837,123	90,042	4.90%
Noninterest earning assets	112,265			86,959		
Total assets	$ 1,946,937			$ 1,924,082		
Interest-bearing liabilities:						
Interest-bearing checking accounts	$ 260,904	$ 311	0.12%	$ 266,061	$ 318	0.12%
Savings accounts	889,170	1,591	0.18%	921,281	1,676	0.18%
Certificates of deposit	29,769	107	0.36%	32,708	116	0.35%
Subordinated debt	8,601	485	5.64%	-	10	0.00%
Total interest-bearing liabilities	1,188,444	2,494	0.21%	1,220,050	2,120	0.17%
Non-interest bearing liabilities	601,067			559,102		
Total liabilities	1,789,511			1,779,152		
Stockholders' equity	157,426			144,930		
Total liabilities and stockholders' equity	$ 1,946,937			$ 1,924,082		
Net interest income		$ 90,411			$ 87,922	
Interest rate spread			4.85%			4.73%
Net interest margin			4.93%			4.79%

1 Includes interest bearing deposit balances we maintain with other financial institutions and the Federal Reserve Bank of San Francisco.

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

3 Includes average balances of non-accrual loans.

The Distribution, Rate and Yield table above sets forth the dollar amounts in interest earned and paid for each major category of interest earning assets and interest-bearing liabilities for the noted periods, as well as their respective yields and costs, and the resulting interest rate spreads and net interest margins.

The Bank's net interest margin, expressed as a percentage of average earning assets, was 4.93% for 2019, up 14 basis points from 4.79% for 2018, even as average earning assets decreased by 0.1% during the year, from $1.84 billion in 2018 to $1.83 billion in 2019. The reason for the increase in the net interest margin was that our average earning assets generated an increase of $2.9 million, from $90.0 million in 2018 to $92.9 million in 2019, partially offset by the increase in funding costs of 17.6%, from $2.1 million in 2018 to $2.5 million in 2019. Our average loan balances increased by $28.2 million, or 2.3%, and the average yield on the entire loan portfolio remained at 6.39% resulting in an increase of interest earnings on loans by $2.9 million, or 3.2%. Yields on our investment securities portfolio increased by 26 basis points and the yield on short term investments went up by 53 basis points. Average total interest-bearing liabilities decreased by 2.6% during 2019, to $1.19 billion from $1.22 billion the previous year.

Net interest income for the year ended December 31, 2019, increased by $2.5 million, to $90.4 million, compared to $87.9 million a year earlier, primarily due to an increase in interest income derived from the growth in our loan portfolio, supplemented by the increase in earnings on average balances on our short term deposits in other banks, including the Federal Reserve Bank of San Francisco.

A substantial portion of the Bank's earning assets are variable-rate loans that re-price when the Bank's reference rate, which usually corresponds with the New York prime lending rate, is changed. This is in contrast to a large base of core deposits that are generally slower to re-price. This causes the Bank's balance sheet to be asset-sensitive, which means that, all else being equal, net interest margin will be higher during periods when short-term interest rates are rising and lower when rates are falling. However, we will not necessarily have to raise rates on the personal savings portion of our core deposits as general market interest rates increase, increasing the sensitivity of our net interest margin to rising interest rates.

The following table provides information regarding the changes in interest income and interest expense, attributable to changes in rates and changes in volumes that contribute to the total change in net interest income for the years ending December 31, 2019 and 2018. Variances attributable to both rate and volume changes are equal to the change in rate times the change in average balance and are included below in the average volume column.

	Years Ended December 31, 2019 vs. 2018 (In thousands)		
	Net Change in Interest Income/Expense	Attributable to: Change in Rate	Change in Volume
Interest income:			
Short term investments	$ 1,016	$ 504	$ 512
Investment securities	(8)	1,282	(1,290)
Loans	1,855	49	1,806
Total interest income	$ 2,863	$ 1,835	$ 1,028
Interest expense:			
Interest-bearing checking accounts	$ (7)	$ (1)	$ (6)
Savings accounts	(85)	(28)	(57)
Certificates of deposit	(9)	2	(11)
Other borrowings	475	-	475
Total interest expense	$ 374	$ (27)	$ 401
Net interest income	$ 2,489	$ 1,862	$ 627

Provision for Loan Losses

Credit risk is inherent in the lending business. The Bank establishes an allowance for loan losses through charges to earnings, which are shown in the statements of income as the provision for loan losses. Specifically identifiable and quantifiable known losses are promptly charged off against the allowance. The provision for loan losses is allocated monthly and evaluated quarterly through a determination of the adequacy of the Bank's allowance for loan losses, and reset if necessary, charging the shortfall, if any, to the current quarter's expense. This has the effect of creating variability in the amount and frequency of charges to the Bank's earnings. The provision for loan losses and level of allowance for each period are dependent upon many factors, including loan growth, net charge-offs, changes in the composition of the loan portfolio, delinquencies, management's assessment of the quality of the loan portfolio, the valuation of problem loans and the general economic conditions in the Bank's market area.

For 2019, the Bank had a provision for loan and credit losses of $9.8 million, which included $6 thousand assigned to the reserve for unfunded credit commitments. The remaining 2019 provision was $3.1 million less than the provision for 2018. The 2019 provision decreased due to no additional provisions being added to the commercial loan borrower that filed for bankruptcy in January 2019 and consumer loan charge-offs decreasing by $1.5 million from 2018. The provision is deemed by management to provide a sufficient allowance for loan losses due to net chargeoffs of $5.7 million during the year, as well as to maintain the allowance for loan losses at a level that is adequate to absorb all reasonably expected future losses and to express management's perception of risk in the existing loan portfolio, as well as changes in the quality of that portfolio.

The allowance for loan losses represented 2.13% and 1.92% of total gross loans at December 31, 2019 and 2018, respectively. Provisions for loan losses are charged to operating income to bring the allowance for loan losses to a level deemed appropriate by the Bank based on the factors discussed under "*Allowance for Loan Losses.*"

Non-interest income

The following table sets forth the various components of the Company's non-interest income:

	Years Ended December 31,		Increase (decrease) 2019 versus 2018	
	2019 Amount	2018 Amount	Amount Change	Percent Change
Non-interest income				
Service charges and fees	$ 6,719	$ 6,550	$ 169	2.6%
Gain (loss) on sale of investment securities	347	(593)	940	158.5%
Income from merchant services	2,338	2,385	(47)	-2.0%
Income from cardholders, net	1,836	1,230	606	49.3%
Trustee fees	2,673	2,548	125	4.9%
Other income	3,766	3,599	167	4.6%
Total non-interest income	$ 17,679	$ 15,719	$ 1,960	12.5%

While net interest income remains the largest single component of total revenues, non-interest income is an important source, as well. In total, the Bank received $17.7 million in non-interest income during 2019, an increase of $2.0 million from the $15.7 million recorded for 2018. The increase from 2018 to 2019 was primarily due to a $347 thousand net investment securities gains in 2019 compared to the $593 thousand in net losses in 2018, resulting in an improvement of $940 thousand during the period. The sale of securities in 2019 and 2018 were necessitated by a need to supplement the Bank's liquidity. In addition, there was a $606 thousand increase in our net income from cardholders due to the consolidation of the Bank's card service provider, resulting in increased interchange revenue.

Non-interest expense

The following table sets forth the various components of the Company's non-interest expense:

	Years Ended December 31,		Increase (decrease) 2019 versus 2018	
	2019 Amount	2018 Amount	Amount Change	Percent Change
Non-interest expense:				
Salaries and employee benefits	$ 36,342	$ 36,654	$ (312)	-0.9%
Occupancy	8,455	7,339	1,116	15.2%
Equipment and depreciation	11,377	10,142	1,235	12.2%
Insurance	1,878	1,759	119	6.8%
Telecommunications	1,394	1,959	(565)	-28.8%
FDIC insurance assessment	889	1,330	(441)	-33.2%
Professional services	2,492	2,686	(194)	-7.2%
Contract services	2,028	1,759	269	15.3%
Other real estate owned	1,237	696	541	77.7%
Stationery and supplies	802	855	(53)	-6.2%
Training and education	997	1,062	(65)	-6.1%
General, administrative and other	8,659	8,786	(127)	-1.4%
Total non-interest expense	$ 76,550	$ 75,027	$ 1,523	2.0%

The following table indicates the percentage of non-interest expense in each category:

	Years Ended December 31,			
	2019		2018	
	Amount	Percent of Total	Amount	Percent of Total
Non-interest expense:				
Salaries and employee benefits	$ 36,342	47%	$ 36,654	49%
Occupancy	8,455	11%	7,339	10%
Equipment and depreciation	11,377	15%	10,142	13%
Insurance	1,878	3%	1,759	2%
Telecommunications	1,394	2%	1,959	3%
FDIC insurance assessment	889	1%	1,330	2%
Professional services	2,492	3%	2,686	4%
Contract services	2,028	3%	1,759	2%
Other real estate owned	1,237	2%	696	1%
Stationery and supplies	802	1%	855	1%
Training and education	997	1%	1,062	1%
General, administrative and other	8,659	11%	8,786	12%
Total non-interest expense	$ 76,550	100%	$ 75,027	100%

Management considers the control of operating expenses to be a critical element of the performance of the Company and the Bank. As in years past, the Bank has undertaken initiatives to contain its non-interest expense and improve its efficiency. Nevertheless, total non-interest expense was $76.5 million for the year ended December 31, 2019, compared to $75.0 million for the year ended December 31, 2018, an increase of $1.5 million. This increase was largely the result of higher costs associated with equipment and depreciation, from $10.1 million in 2018 to $11.4 million in 2019, the rise in occupancy expense, and an increase in other real estate owned, which went up by $1.1 million, and $541 thousand, respectively. Those increases were primarily offset by a reduction of $565 thousand in telecommunications expense, and a $441 thousand decrease in FDIC insurance assessment.

Income Tax Expense

The Company computes its provision for income taxes on a monthly basis. The effective tax rate is determined by applying the Bank's statutory income tax rate to pre-tax book income, as adjusted for permanent differences between pre-tax book income and actual taxable income. These permanent differences include, but are not limited to, tax-exempt interest income, increases in the cash surrender value of life insurance policies, certain expenses that are not allowed as tax deductions, and tax credits.

The Bank pays income taxes in Guam and the Commonwealth of the Northern Mariana Islands under a territorial "mirror" of the U.S. Internal Revenue Code, with payments made to the respective territorial governments instead of the U.S. Treasury; there is no equivalent of a state income tax in either of these jurisdictions. The Bank also pays taxes to the governments of the Republic of Palau, the Federated States of Micronesia, the Republic of the Marshall Islands and the State of California. The Bank's territorial and state income tax expense in 2019 was $5.6 million, as compared to an income tax expense of $2.9 million in 2018. The Tax Cuts and Jobs Act reduced the maximum corporate tax rate from 35% to 21% commencing on January 1, 2018.

The difference in the effective tax rate compared to the combined territorial, foreign and state statutory tax rate of 21% in effect for 2019 is primarily the result of the Bank's portfolio of tax-exempt loans to the government of Guam totaling $10.2 million and $14.1 million at December 31, 2019 and 2018, respectively. Additionally, there was a one-time impact on total income tax expense and the effective tax rate in 2019 due to a $921 thousand adjustment.

Some items of income and expense are recognized in different years for tax purposes than when applying generally accepted accounting principles, leading to timing differences between the Bank's actual tax liability and the amount accrued for this liability based on book income. These temporary differences comprise the "deferred" portion of the Bank's tax expense or benefit, which is accumulated on the Bank's books as a deferred tax asset or deferred tax liability until such time as they reverse. At the end of the years 2019 and 2018, the Bank had a gross deferred tax asset of $6.8 million and $6.9 million, respectively.

Realization of the net deferred tax asset is primarily dependent upon the Bank generating sufficient taxable income to obtain a benefit from the reversal of net deductible temporary differences, utilization of tax credit carry-forwards and the net operating loss carry-forwards for Guam, the Commonwealth of the Northern Mariana Islands and California state income tax purposes. The amount of deferred tax assets considered realizable is subject to adjustment in future periods based on estimates of future taxable income. Under generally accepted accounting principles, a valuation allowance is required to be recognized if it is "more likely than not" that a deferred tax asset will not be realized. The determination of whether the deferred tax assets will actually be realized is highly subjective and dependent upon judgment concerning management's evaluation of both positive and negative evidence, including forecasts of future income, cumulative losses, applicable tax planning strategies, and assessments of current and future economic and business conditions.

In assessing the realization of deferred tax assets at December 31, 2019, based on these factors, the Bank believed that it was more likely than not that the Bank will realize only $7.5 million of the benefits of these deductible differences. Therefore, a valuation allowance of $1.8 million for its deferred tax asset was recorded at December 31, 2019.

In assessing the realization of deferred tax assets at December 31, 2018, the Bank believed that it was more likely than not that the Bank would realize only $6.9 million of the benefits of these deductible differences. Therefore, a valuation allowance of $2.2 million for the deferred tax asset was recorded at December 31, 2018.

Financial Condition

As of December 31, 2019, total assets were $1.95 billion, an increase of 3.2% from $1.89 billion at December 31, 2018. Total securities available-for-sale (at fair value) were $377.1 million, a decrease of 1.0% from $381.0 million at December 31, 2018. The total loan portfolio, net of allowance for loan losses and deferred fees, was $1.27 billion, an increase of $63.1 million, or 5.2% from $1.21 billion at year-end 2018. Interest bearing deposits in banks decreased during 2019, falling to $93.8 million from $121.8 million at the end of 2018. Total deposits were $1.73 billion, an increase of just 0.1% from $1.73 billion at year-end 2018. The Bank had no short-term borrowings at December 31, 2019.

Securities Portfolio

The following table reflects the estimated fair value of Available-for-Sale securities and the amortized cost of Held-to-Maturity securities, for each category for the past two years:

Investment Portfolio

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ 75,496	$ 3	$ (64)	$ 75,435
U.S. government agency pool securities	174,543	42	(1,088)	173,497
U.S. government agency or GSE residential mortgage-backed securities	128,409	181	(392)	128,198
Total	$ 378,448	$ 226	$ (1,544)	$ 377,130
Securities Held-to-Maturity				
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ 31,723	$ 286	$ (1)	$ 32,008
U.S. government agency pool securities	5,727	6	(70)	5,663
U.S. government agency or GSE residential mortgage-backed securities	12,534	67	(68)	12,533
Total	$ 49,984	$ 359	$ (139)	$ 50,204

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ 100,497	$ -	$ (1,587)	$ 98,910
U.S. government agency pool securities	213,055	24	(1,707)	211,372
U.S. government agency or GSE residential mortgage-backed securities	72,735	-	(1,975)	70,760
Total	$ 386,287	$ 24	$ (5,269)	$ 381,042
Securities Held-to-Maturity				
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ 38,445	$ 46	$ (88)	$ 38,403
U.S. government agency pool securities	9,089	3	(80)	9,012
U.S. government agency or GSE residential mortgage-backed securities	20,554	29	(521)	20,062
Total	$ 68,088	$ 78	$ (689)	$ 67,477

The amortized cost and fair value of investment securities by contractual maturity at December 31, 2019, are shown below.

	December 31, 2019			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	$ 55,022	$ 54,980	$ 19,840	$ 19,982
Due after one but within five years	26,868	26,838	14,680	14,796
Due after five but within ten years	101,390	101,252	7,172	7,211
Due after ten years	195,168	194,060	8,292	8,215
Total	$ 378,448	$ 377,130	$ 49,984	$ 50,204

The securities portfolio is the second largest component of the Bank's interest earning assets, and the structure and composition of this portfolio is important to an analysis of the financial condition of the Bank and the Company. The portfolio serves the following purposes: (i) it provides a source of pledged assets for securing certain deposits and borrowed funds, as may be required by law or by specific agreement with a depositor or lender; (ii) it can be used as an interest rate risk management tool, since it provides a large base of assets, the maturity and interest rate characteristics of which can be changed more readily than the loan portfolio to better match changes in the deposit base and other funding sources of the Bank; and (iii) it is an alternative interest earning use of funds when loan demand is weak or when deposits grow more rapidly than loans.

Approximately eighty-eight percent of the Bank's securities at December 31, 2019, were classified under existing accounting rules as "Available-for-Sale" to allow flexibility in the management of the portfolio. Accounting guidance requires Available-for-Sale securities to be marked to fair market value, with an offset to other comprehensive income (loss), a component of stockholders' equity, recorded on a quarterly basis. The remaining 11.7% of the investment portfolio was in Held-to-Maturity securities, which the Bank is willing and believes it will be able to retain until they mature, and which are recorded on an amortized cost basis.

The Bank's portfolio has historically been comprised primarily of: (i) U.S. government agency and sponsored entities' debt securities for liquidity and pledging; (ii) U.S. government agency and sponsored entities' mortgage-backed securities, which in many instances can also be used for pledging, and which generally enhance the yield of the portfolio; and (iii) U.S. government agency pool securities, which generally enhance the yield of the portfolio. Since the downgrade of many municipal obligations and their respective insurers in the past few years, the Bank no longer holds municipal bonds, but may do so again when markets become more stable.

Compared to December 31, 2018, the Bank's securities portfolio decreased by $22.0 million to 21.9% of total assets at December 31, 2019, from 23.7% at December 31, 2018. The Bank increased its holding of mortgage-back securities by $49.4 million to $140.7 million at December 31, 2019, from $91.3 million at December 31, 2018. During the same period, the Bank's holdings of U.S. government agency pool securities decreased by $41.2 million, to $179.2 million, and its holdings of U.S. government agency and sponsored enterprise debt securities decreased by $30.2 million, to $107.2 million. The Bank has not used interest rate swaps or other derivative instruments to hedge fixed rate loans or securities to otherwise mitigate interest rate risk.

Loans

The Bank's loans represent the largest portion of earning assets, substantially greater than the securities portfolio or any other asset category, and the quality and diversification of the loan portfolio is an important consideration when assessing the financial condition of the Bank and the Company.

Gross loans represented 66.9% of total assets at December 31, 2019, as compared to 65.5% at December 31, 2018. The ratio of gross loans to deposits increased to 75.5% at the end of 2019 from 71.6% at the end of 2018. Demand for loans has strengthened within the Bank's Northern Mariana and California markets, and was favorable in the Freely Associated States and Guam markets. The 29.8% increase in gross loans outstanding in the Commonwealth of the Northern Mariana Islands is due to the growth in commercial & Industrial loans, commercial mortgage loans and in commercial construction loans, while the 12.0% growth in the Freely Associated States and Guam is primarily due to new commercial & industrial loans, and the 6.3% growth in California is due to continuing strength in the economy there.

The Loan Distribution table that follows sets forth the Bank's gross loans outstanding, deferred fee income amortized over the life of some loans, the allowance for loan losses and the percentage distribution in each loan category at the dates indicated.

Loan Portfolio

	December 31,			
	2019		2018	
	Amount	Percent	Amount	Percent
Commercial				
Commercial & industrial	$ 282,426	21.6%	$ 243,465	19.7%
Commercial mortgage	591,364	45.3%	560,827	45.3%
Commercial construction	71,101	5.4%	39,408	3.2%
Commercial agriculture	664	0.1%	688	0.1%
Total commercial	945,555	72.4%	844,388	68.2%
Consumer				
Residential mortgage	124,250	9.5%	138,923	11.2%
Home equity	2,685	0.2%	1,325	0.1%
Automobile	21,631	1.7%	26,686	2.2%
Other consumer loans[1]	211,884	16.2%	227,242	18.3%
Total consumer	360,450	27.6%	394,176	31.8%
Gross loans	1,306,005	100.0%	1,238,564	100.0%
Deferred loan (fees) costs, net	(2,863)		(2,649)	
Allowance for loan losses	(27,870)		(23,774)	
Loans, net	$ 1,275,272		$ 1,212,141	

1 Comprised of other revolving and installment credit and overdrafts.

About three fourths of the Bank's loan portfolio is concentrated in commercial loans (which include loans to governments), primarily in commercial real estate, multifamily rentals, hotels and gas stations, with the balance in working capital and equipment financing. These are followed by other consumer loans and residential mortgages. The increase in the Bank's loan portfolio in 2019 was due to customary loan activity throughout our markets, increases in the commercial mortgage portfolios in the Commonwealth of the Northern Mariana Islands and California region, and the addition of two significant commercial & industrial loans in the Freely Associated States and Guam region. The Bank's gross loans were concentrated in Guam and San Francisco, at 83.2% of our gross loan portfolio as of December 31, 2019, compared to 85.3% as of December 31, 2018. The only industry concentration that was considered significant at December 31, 2019, was within our commercial mortgage loan portfolio, which was at 45.3% of total gross loans in 2019 and 2018.

The Bank's commercial & industrial loans are made for working capital, financing the purchase of equipment and other business purposes. Commercial loans include loans with maturities ranging from thirty days to one year and "term loans" with maturities normally ranging from three to fifteen years. Short- term business loans are generally intended to finance current transactions and typically provide for periodic principal payments, with interest payable monthly. Term loans normally carry floating interest rates, with monthly payments of both principal and interest, but may be amortized over a longer period than the term of the loan, with a balloon payment at the end of the term.

The Bank is an active participant in the Small Business Administration (SBA), State Small Business Credit Initiative (SSBCI), Nor-Cal Financial Development Corp. and U.S. Department of Agriculture guaranteed lending programs, and has been approved by the SBA as a lender under the Preferred and Patriot Express Lender Programs. The Bank regularly makes such guaranteed loans, with an outstanding volume of $8.9 million at December 31, 2019.

As of December 31, 2019, commercial and residential real estate loans of $789.4 million consist primarily of adjustable and fixed rate loans secured by deeds of trust or mortgages on commercial and residential property, and comprised 60.4% of the total loan portfolio. The Bank's commercial mortgages at December 31, 2019, consist of $591.4 million, or 45.3% of gross loans. Commercial construction loans comprise $71.1 million, or 5.4%, of gross loans. Residential mortgages, including home equity loans, were $126.9 million, or 9.7% of gross loans. Properties securing the commercial and residential real estate loans are located in the Bank's primary markets, which include the San Francisco Bay area.

The Bank's commercial real estate loans consist primarily of loans based on the borrower's cash flow and are secured by deeds of trust or mortgages on commercial and residential property to provide a secondary source of repayment. The Bank generally restricts commercial real estate term loans to no more than the lower of 75% of the property's appraised value or the purchase price of the property, whichever is lower, during the initial underwriting of the credit, depending on the type of property and its utilization. The Bank offers both fixed and floating rate loans. Maturities on commercial real estate loans are generally ten to fifteen years (with amortization up to thirty years and a balloon payment due at maturity), and maturities on residential mortgage loans are typically between 15 and 30 years, with many of those loans sold to the Federal Home Loan Mortgage Corporation with the retention of servicing rights. SBA and certain other real estate loans that can be sold in the secondary market may be granted for longer maturities.

The Bank's construction loans primarily finance the development and construction of commercial and residential properties. The Bank uses underwriting guidelines to assess the likelihood of repayment from sources such as sale of the property or availability of permanent mortgage financing prior to making the construction loan. Construction loans increased by $31.7 million to $71.1 million at December 31, 2019, from $39.4 million at December 31, 2018.

Additionally, the Bank makes consumer loans for the purpose of financing automobiles, various types of consumer goods, and other personal purposes. Consumer loans generally provide for the monthly payment of principal and interest. Most of the Bank's consumer loans are either unsecured, secured by the personal property being purchased or, in the case of home equity loans, real property.

At December 31, 2019, total gross loans had increased during the year by $67.4 million, or 5.4%, to $1.31 billion from $1.24 billion at December 31, 2018. The increase was largely attributed to a $101.2 million increase in commercial loans to $945.5 million at December 31, 2019, from $844.4 million at December 31, 2018. This was primarily due to increases in commercial & industrial loans $39.0 million, commercial mortgage loans $30.5 million and commercial construction loans $31.7 million. The increase was partially offset by a $15.4 million decrease during 2019 in other consumer loans, $14.7 million in residential mortgage and $5.1 million in automobile loans.

At December 31, 2019, loans outstanding were comprised of approximately 69.11% variable rate loans and 30.89% 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 gross loans in the Bank's administrative regions for the years ending December 31, 2019, and 2018:

	At December 31,	
	2019	2018
Guam	$ 704,443	$ 697,722
Commonwealth of the Northern Mariana Islands	$ 117,226	$ 90,291
The Freely Associated States of Micronesia *	$ 102,665	$ 91,640
California	$ 381,671	$ 358,911
Total	$ 1,306,005	$ 1,238,564

* 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 gross loans increased by 5.5% during 2019. Total loans in the Commonwealth of the Northern Mariana Islands increased by $26.9 million, or 29.8%, accounting for the largest source of total portfolio growth during 2019. Loan growth in California was second, with growth at $22.8 million, or 6.3%. These two regions account for 73.7% of total loan growth in 2019. The economy in the Commonwealth of the Northern Mariana Islands is recovering from two major typhoons during 2018, which has increased demand for credit funding.

Loan Maturities

The following table presents the maturity distribution of the Bank's loans as of December 31, 2019. The table also shows the distribution of such loans between those with predetermined (fixed) interest rates and those with variable (floating) interest rates. Floating rates generally fluctuate with changes in the New York prime rate, as reflected in The Wall Street Journal, and the Bank of Guam prime rate.

	At December 31, 2019				
	Due in Less Than 1 Year	Due in More Than 1 Year But Less Than 5 Years	Due in More Than 5 Years	Non-Accrual	Total
	(Dollars in thousands)				
Commercial loans	$ 13,261	$ 325,926	$ 587,680	$ 18,687	$ 945,554
Residential mortgages	389	9,262	113,915	3,370	126,936
Consumer loans	18,372	130,798	84,139	206	233,515
Total	$ 32,022	$ 465,986	$ 785,734	$ 22,263	$ 1,306,005
Variable rate loans	$ 12,865	$ 253,103	$ 618,317	$ 18,345	$ 902,630
Fixed rate loans	19,157	212,883	167,417	3,918	403,375
Total	$ 32,022	$ 465,986	$ 785,734	$ 22,263	$ 1,306,005

Loan Servicing

As of December 31, 2019 and 2018, there were $189.5 million and $189.6 million, respectively, in Federal Home Loan Mortgage Corporation loans that were serviced by the Bank.

Loan servicing rights are included in Accrued Interest Receivable and Other Assets on the consolidated balance sheets, and are reported at their estimated fair value.

Nonperforming Assets

Financial institutions generally have a certain level of exposure to credit quality risk, and could potentially receive less than a full return of principal and interest if a debtor becomes unable or unwilling to repay. Since loans are the most significant assets of the Bank and generate the largest portion of its revenues, the Bank's management of credit risk is focused primarily on loan quality.

Banks have generally suffered their most severe earnings declines as a result of customers' inability to generate sufficient cash flow to service their debts, and/or downturns in national and regional economies and declines in overall asset values, including real estate prices.

The Bank's credit policies identify allowable geographic credit concentrations. In addition, these policies establish the Bank's underwriting standards and the methods of monitoring credit quality on an ongoing basis. The Bank's internal credit risk controls are focused on underwriting practices, credit originating procedures, training, risk management techniques, and familiarity with loan customers, as well as the relative diversity and geographic concentration of our loan portfolio.

The Bank's credit risk may also be affected by external factors, such as the level of interest rates, employment, general economic conditions, real estate values, and trends in particular industries or geographic markets. As an independent community bank serving a specific geographic area, the Bank must contend with the unpredictable changes in the general regional market and, particularly, primary local markets. The Bank's asset quality has been affected in the past by the impact of national and regional recessions, consumer bankruptcies, and depressed real estate values.

Nonperforming assets are comprised of the following: loans for which the Bank is no longer accruing interest; restructured loans that are more than 90 days past due; loans 90 days or more past due and still accruing interest (although they are generally placed on non-accrual when they become 90 days past due, unless they are both well-secured and in the process of revision or collection); and other real estate owned ("OREO") that is acquired through foreclosures. Management's classification of a loan as "non-accrual" is an indication that there is reasonable doubt as to the full recovery of principal or interest on the loan. At that point, the Bank stops accruing interest income, and reverses any uncollected interest that had previously been accrued. These loans may or may not be collateralized, and collection efforts are pursued. The Bank begins recognizing interest income again only as cash interest payments are received and it has been determined that the collection of all outstanding principal is no longer in doubt. Loans may be restructured by management when a borrower has experienced some change in financial status causing an inability to meet the original repayment terms and where the Bank believes the borrower will eventually overcome those circumstances and make full repayment. OREO consists of properties acquired by foreclosure or similar means that management is offering or will offer for sale. Total OREO, net of OREO reserves, was $6.0 thousand at December 31, 2019, compared to $1.5 million at December 31, 2018. The decrease in OREO is primarily due to the charge off of two foreclosed properties in California in order to meet regulatory requirements.

Nonperforming Assets

The following table provides information about nonperforming assets by asset type as of December 31, 2019 and 2018:

	December 31, 2019	December 31, 2018
	(Dollars in Thousands)	
Nonperforming Assets:		
Non-accrual loans past due 30 days or more	$ 9,244	$ 5,089
Loans past due 90 days or more still accruing	17,493	1,984
Restructured loans past due 30 days – not included above	77	-
Other Real Estate Owned, gross	8	1,543
Total Nonperforming Assets	$ 26,822	$ 8,616

The following table provides information about nonperforming loans by loan type:

	December 31, 2019	December 31, 2018
	(Dollars in Thousands)	
Nonperforming Loans:		
Commercial:		
Commercial & industrial	$ 4,076	$ 544
Commercial mortgage	2,966	1,471
Commercial construction	-	-
Commercial agriculture	-	-
Total commercial	7,042	2,015
Consumer:		
Residential mortgage	2,227	3,471
Home equity	-	91
Automobile	93	136
Other consumer [1]	1,671	1,360
Total consumer	3,991	5,058
Total nonperforming loans	$ 11,033	$ 7,073

1 Comprised of other revolving and installment credit and overdrafts.

Allowance for Loan Losses

The Bank maintains its allowance for loan losses at a level which, in management's judgment, is adequate to absorb prospective credit losses inherent in the loan portfolio as of the balance sheet date. The amount of the allowance is based on management's 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, along with their related impacts on specific borrowers and industry groups. The allowance is increased by provisions for loan losses, which are charged against earnings, and reduced by charge-offs, net of recoveries. Because of uncertainties inherent in the estimation process, management's estimate of potential credit losses in the loan portfolio and the related allowance may change from time to time.

The Bank's allowance for loan losses increased by $4.1 million to $27.9 million during 2019 from $23.8 million at the end of 2018. The increase in the allowance for loan losses in 2019 was based primarily on net losses in our loan portfolio, particularly in consumer loans, and specific reserves for two commercial borrowers that filed for Bankruptcy in 2019, and management's periodic reevaluation of the overall portfolio's inherent risk. The Bank had $7.9 million in charge-offs in 2019, which were partially offset by recoveries of previously charged-off loans of $2.2 million. $1.0 million of 2019 charged off loans was from one of the commercial loan borrowers that filed for Bankruptcy in April 2019. The $1.0 million charge off was offset from the specific reserve for that borrower.

Net loans charged-off includes the realization of losses in the portfolio that were partially recognized previously through provisions for loan losses and write-downs of loan principal valuations. Net charge-offs were $5.7 million in 2019, compared to $6.4 million in 2018. The 2019 net was lower primarily due to lower charge-offs in the consumer loan portfolio. Historical net loan charge-offs are not necessarily indicative of the amount of net charge-offs that the Bank will realize in the future.

The table in Note 6 to the Consolidated Financial Statements – Loans, under *Credit Quality Indicators*, provides a summary of the allocation of the allowance for loan losses for specific categories at the dates indicated. The allocation presented should not be interpreted as an indication that charges to the allowance for loan losses will be incurred in these amounts or proportions, or that the portion of the allowance allocated to each category represents the total amount available for charge-offs that may occur within these categories.

Allocation of Loan Loss Allowance

The material set forth in Note 6 of Notes to Consolidated Financial Statements in Item 15 of this Annual Report on Form 10-K is incorporated by reference.

Deposits

The composition and cost of the Bank's deposit base are important components in analyzing the Bank's net interest margin and balance sheet liquidity characteristics, both of which are discussed in greater detail in other sections in this report. The Bank's liquidity is impacted by the volatility of deposits or other funding instruments or, in other words, by the propensity of that money to leave the institution for interest rate-related or other reasons. Deposits can be adversely affected if economic conditions in the Bank's market area weaken. Potentially, the most volatile deposits in a financial institution are jumbo certificates of deposit, meaning time deposits with balances that equal or exceed $250,000, as customers with balances of that magnitude are typically more rate-sensitive than customers with smaller balances.

The following table summarizes the distribution of deposits for the periods indicated:

	December 31, 2019	December 31, 2018
	(Dollars in Thousands)	
Non-interest bearing deposits	$ 582,967	$ 538,168
Interest bearing deposits:		
Demand deposits	278,914	281,582
Regular savings	627,596	670,640
Time deposits:		
$250,000 or more	14,201	14,201
Less than $250,000	17,797	21,986
Other interest bearing deposits	208,431	202,246
Total interest bearing deposits	1,146,939	1,190,655
Total Deposits	$ 1,729,906	$ 1,728,823

The Bank gathers deposits from among the communities it serves. The Bank's business is not generally seasonal in nature, and the Bank is not primarily dependent upon funds from sources outside the United States of America, but approximately 24.7% of its deposit base at December 31, 2019, is acquired in the Micronesian islands that are politically organized in free association with the United States and use the U.S. dollar as their currency. At December 31, 2019 and 2018, 31.5% and 33.2% of deposits, respectively, were from domestic and foreign government sources.

Non-interest and low interest-bearing demand deposits increased by $42.1 million, or 5.1%, to $861.9 million at December 31, 2019, compared to $819.7 million at December 31, 2018. Other interest bearing deposits, which are comprised of time deposit open accounts, increased by $6.2 million, or 3.1%, to $208.4 million at December 31, 2019, compared to $202.2 million at December 31, 2018.

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, 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, 2019, and 2018:

	At December 31,	
	2019	**2018**
Guam	$ 966,217	$ 900,273
Commonwealth of the Northern Mariana Islands	$ 289,605	$ 334,987
The Freely Associated States of Micronesia *	$ 427,786	$ 447,011
California	$ 46,298	$ 46,552
Total	$ 1,729,906	$ 1,728,823

* 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 2019, deposits increased by a total of $1.1 million. Deposits in Guam of which $65.9 million was in our Guam Branches, largely offset by $45.4 million our Commonwealth of the Northern Mariana Islands branches, $19.2 million in the Freely Associated States branches, and $0.3 million in the California region. Overall, the Bank's deposit base increased by 0.06% during 2019.

Deposit Maturity Distribution

At December 31, 2019 , the scheduled maturities of time deposits were as follows:

Years ending December 31,	
2020	$ 26,853
2021	1,957
2022	803
2023	261
2024 and thereafter	2,124
Total	$ 31,998

The Bank provides and services government and business deposit accounts that are frequently more than $250,000 in average balance per account. The account activity for some account types and client types necessitates appropriate liquidity management practices by the Bank to ensure its ability to fund withdrawals.

Off-Balance Sheet Arrangements

In the normal course of business, the Bank makes commitments to extend credit to its customers as long as there are no violations of any conditions established in the associated contractual arrangements. These commitments are obligations that represent a potential credit risk to the Bank, yet are not reflected in any form within the Company's consolidated balance sheets other than in a modest contingency reserve against those commitments. Total unused commitments to extend credit were $157.5 million at December 31, 2019 , as compared to $163.8 million at December 31, 2018. Unused commitments represented 12.1% of outstanding gross loans at December 31, 2019 and 13.2% at December 31, 2018.

The effect on the Bank's revenues, expenses, cash flows and liquidity from the unused portion of the commitments to provide credit cannot be reasonably predicted, because there is no certainty that these lines of credit will ever be fully utilized, if at all. For more information regarding the Company's off-balance sheet arrangements, see Note 16 to the financial statements located elsewhere herein.

The following table presents the Bank's commitments to extend credit for the periods indicated:

	December 31,	
	2019	2018
Commitments to extend credit	$ 157,463	$ 163,802
Letters of credit:		
Standby letters of credit	$ 58,182	$ 55,418
Commercial letters of credit	513	3,070
Total	$ 58,695	$ 58,488

Contractual Obligations

The Bank utilizes facilities, equipment and land under various operating leases with original terms ranging from 1 to 99 years.

The following table provides the maturities of lease liabilities at December 31, 2019:

	Operating Leases (a)	Finance Leases	Total
2020	$ 3,426	$ -	$ 3,426
2021	3,221	-	3,221
2022	2,700	-	2,700
2023	2,486	-	2,486
2024	2,334	-	2,334
After 2024	40,238	-	40,238
Total lease payments	$ 54,405	$ -	$ 54,405
Less: Interest (b)	24,246	-	24,246
Present value of lease liabilities (c)	$ 30,159	$ -	$ 30,159

Note: For leases commencing prior to 2019, minimum lease payments exclude payments to landlords for real estate taxes and common area maintenance.

(a) Operating lease payments include $25.9 million related to options to extend lease terms that are reasonably certain of being exercised.

(b) Calculated using the incremental borrowing rate based on the lease term for each lease.

(c) Includes the current portion of $2.4 million for operating leases.

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 years ended December 31, 2019, and 2018, approximated $354 thousand, and $350 thousand, respectively.

Additionally, the Bank leases office space to third parties, with original lease terms ranging from 1 to 3 years and option periods ranging up to 12 years. At December 31, 2019, minimum future rents to be received under non-cancelable operating sublease agreements were $34 thousand, and $8 thousand for the years ending December 31, 2020, and 2021, respectively. Although it is possible that one or more of these leases will be renewed, there is no certainty upon which to base an estimate.

A summary of rental activities for years ended December 31, 2019, and 2018, is as follows:

	For Years Ended December 31,	
	2019	2018
Rent expense	$ 3,876	$ 2,915
Total rent expense	$ 3,876	$ 2,915

Liquidity and Asset/Liability Management

Liquidity refers to the Bank's ability to maintain cash flows sufficient to fund operations and to meet obligations and other commitments in a timely and cost-effective fashion. At various times the Bank requires funds to meet short-term cash requirements brought about by loan growth or deposit outflows, the purchase of assets, or liability repayments. The Bank's large base of core deposits is an integral part of its ability to manage its liquidity position appropriately. These core deposits are generated by offering traditional banking services in its service areas and have, historically, been a stable source of funds. To manage liquidity needs properly, cash inflows must be timed to coincide with anticipated outflows, or other sufficient liquid resources must be available to meet varying demands. The Bank manages cash and investment securities in order to be able to meet unexpected, sudden changes in levels of its assets or deposit liabilities without maintaining excessive amounts of balance sheet liquidity. Excess balance sheet liquidity can negatively impact the Bank's interest margin. In order to meet short-term liquidity needs, the Bank may utilize overnight Federal Funds purchases and other borrowing arrangements with correspondent banks, and use interest rate pricing to attract new deposits from local sources; it also maintains collateralized lines of credit with the FHLB and the FRB. In addition, the Bank can obtain cash for temporary needs by selling securities that it classifies as Available-for-Sale.

At December 31, 2019, the Bank had an increase in gross loans of $67.4 million from December 31, 2018. One of the measures of liquidity is our loan-to-deposit ratio, based upon gross loans, which increased to 75.5% at, compared to 71.6% at December 31, 2018. Each calendar quarter, the Bank performs a six-month cash flow analysis to ensure that it will have sufficient liquidity to meet all of its potential cash obligations under a worst-case scenario, and maintains more than adequate liquidity under those hypothetical conditions.

FHLB, FRB and Other Borrowings and Available Lines of Credit

The Bank has off-balance sheet liquidity in the form of Federal Funds purchase arrangements with correspondent banks, as well as collateralized borrowing arrangements with the FHLB and the FRB. The Bank can borrow from the FHLB on a short-term (typically overnight) or long-term (more than one year) basis. At December 31, 2019, the Bank had no long-term borrowings. The Bank had an available line of credit of $131.2 million with the FHLB of Des Moines at December 31, 2019.

The Bank can also borrow from the FRB's discount window. It had $20.9 million of investment securities pledged to the FRB San Francisco as collateral on an available line of credit of $20.3 million at December 31, 2019, none of which credit was outstanding.

At December 31, 2019, the Bank had arrangements for Federal Funds purchases of up to a total of $17.0 million from three of its U.S. correspondent financial institutions. The Bank had no Federal Funds purchases outstanding at December 31, 2019 and 2018.

At December 31, 2019, the Company had no other borrowed funds.

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 its 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, Tier 1 and common equity 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, as of December 31, 2019 and 2018, that the Bank met all capital adequacy requirements to which it is subject.

As of December 31, 2019, the Bank's capital ratios each exceeded the FDIC's well capitalized standards 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 new capital standards under the U.S. adoption of Basel III establish a capital conservation buffer, which must consist entirely of common equity Tier 1 capital. The capital conservation buffer was fully phased-in on January 1, 2019. The buffer was 0.625% of risk-weighted assets for 2016, 1.25% for 2017, and is 1.875% for 2018, and 2.5% for 2019 and thereafter. Failure to meet these standards could result in restrictions on our ability to pay dividends and to pay discretionary bonuses to executive management.

The Company's actual capital amounts and ratios as of December 31, 2019 and 2018, are presented in the table below.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
At December 31, 2019:						
Total capital (to Risk Weighted Assets)	$ 197,000	14.417%	$ 109,313	8.000%	$ 136,641	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 164,787	12.060%	$ 81,985	6.000%	$ 109,313	8.000%
Tier 1 capital (to Average Assets)	$ 164,787	8.418%	$ 78,298	4.000%	$ 97,873	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 155,005	11.344%	$ 61,489	4.500%	$ 88,817	6.500%
At December 31, 2018:						
Total capital (to Risk Weighted Assets)	$ 167,732	13.662%	$ 98,219	8.000%	$ 122,774	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 152,281	12.403%	$ 73,664	6.000%	$ 98,219	8.000%
Tier 1 capital (to Average Assets)	$ 152,281	7.991%	$ 76,229	4.000%	$ 95,287	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 142,498	11.607%	$ 55,248	4.500%	$ 79,803	6.500%

Market Risk

Market risk is the risk of loss of future earnings, fair values or cash flows that may result from changes in the price of a financial instrument. The value of a financial instrument may change as a result of changes in interest rates, foreign currency exchange rates, commodity prices, equity prices and other market changes that affect market risk sensitive instruments. Market risk is an attribute of all market risk sensitive financial instruments, including securities, loans, deposits and borrowings, as well as a company's role as a financial intermediary in customer-related transactions. The objective of market risk management is to avoid excessive exposure of the company's earnings and equity to loss, and to reduce the volatility inherent in certain types of financial instruments.

Interest Rate Risk Management

Market risk arises from changes in interest rates, exchange rates, commodity prices and equity prices. The Bank's market risk exposure is primarily that of interest rate risk, and it has established policies and procedures to monitor and limit earnings and balance sheet exposure to changes in interest rates. The Bank does not engage in the trading of financial instruments, and has only nominal direct exposure to currency exchange rate risk, but has indirect exposure to exchange rate risk because of the dominant position of foreign tourism in its primary markets.

The principal objective of interest rate risk management (often referred to as "asset/liability management") is to manage the financial components of the Bank's balance sheet, as well as their characteristics, in a manner that will optimize the risk/reward equation for earnings and capital in relation to changing interest rates. The Bank's exposure to market risk is reviewed on a monthly basis by its Asset and Liability Committee. Interest rate risk is the potential for economic losses due to future interest rate changes. These economic losses can be reflected as a loss of future net interest income and/or a loss of current fair market values. The objective is to measure the effect on net interest income and to adjust the balance sheet to minimize the inherent risk while simultaneously maximizing income. Management realizes certain risks are inherent, and that the goal is to identify and manage those risks. Management uses two methodologies to manage interest rate risk: (i) a standard GAP analysis; and (ii) an interest rate shock simulation model.

The planning of asset and liability maturities is an integral part of the management of an institution's net interest margin. To the extent that the maturities of assets and liabilities do not match in a changing interest rate environment, the net interest margin may change over time. Even with perfectly matched re-pricing of assets and liabilities, risks remain in the form of prepayment risk for some loans and securities, or in the form of risks of delays in the adjustment of interest rates applying to either earning assets with floating rates or to interest bearing liabilities. The Bank has generally been able to control its exposure to changing interest rates by maintaining a substantial proportion of its portfolio in floating interest rate loans and a majority of its time deposits with relatively short maturities.

Interest rate changes do not affect all categories of assets and liabilities equally or at the same time. Varying interest rate environments can create unexpected changes in prepayment levels of assets and liabilities, which may have a significant effect on the net interest margin and are not reflected in the interest sensitivity analysis table. Because of these factors, an interest sensitivity gap report may not provide a complete assessment of the exposure to changes in interest rates.

The Bank uses modeling software for asset/liability management in order to simulate the effects of potential interest rate changes on its net interest margin, and to calculate the estimated fair values of the Bank's financial instruments under different interest rate scenarios. The program utilizes current balances, interest rates, maturity dates and re-pricing information for individual financial instruments, and incorporates assumptions on the characteristics of embedded options along with pricing and duration for those instruments to project the effects of a given interest rate change on the Bank's interest income and interest expense. Rate scenarios consisting of key rate and yield curve projections are run against the Bank's investment, loan, deposit and borrowed funds portfolios. These rate projections can be shocked (an immediate and parallel change in all base rates, up or down) and ramped (with incremental increases or decreases in rates over a specified time period), based on current trends and forecasts, including stable economic conditions.

The following table sets forth the estimated changes in the Bank's net interest income that would result from the designated instantaneous parallel shifts in interest rates noted, as of December 31, 2019. Computations of prospective effects of hypothetical interest rate changes are based on numerous assumptions, including relative levels of market interest rates, loan prepayments and deposit decay, and should not be relied upon as indicative of actual results. (Please note that, in the current interest rate environment, the larger reductions in rates presented in the analysis are unlikely to occur.)

	Increase/(Decrease) in Estimated Net Interest Income	
	Amount	**Percent**
	(Dollars in thousands)	
Change in Interest Rates (basis points)		
+400	$ 34,370	40.46%
+300	$ 26,036	30.65%
+200	$ 17,703	20.84%
+100	$ 9,448	11.12%
± 0	$ -	0.00%
-100	$ (8,177)	-9.62%
-200	$ (14,070)	-16.56%
-300	$ (17,671)	-20.80%
-400	$ (21,270)	-25.04%

These data do not reflect any actions that we may undertake in response to changes in interest rates, such as changes in rates paid on certain deposit accounts based on local competitive factors, which could improve or attenuate the actual impact on net interest income.

As with any method of gauging interest rate risk, there are certain shortcomings inherent to the methodology noted above. The model assumes interest rate changes are instantaneous, and result in parallel shifts in the yield curve. In reality, rate changes are rarely instantaneous. The use of the simplifying assumption that short-term and long-term rates change by the same degree also disregards historic rate change patterns, which rarely show parallel yield curve shifts. Further, the model assumes that certain assets and liabilities of similar maturity or period to re-pricing will react in the same way to changes in rates. In reality, certain types of financial instruments may react in advance of changes in market rates, while the reaction of other types of financial instruments may lag significantly behind the change in general market rates. Additionally, the methodology noted above does not reflect the full impact of annual and lifetime restrictions on changes in rates for certain assets, such as adjustable rate loans. When interest rates change, actual loan prepayments and actual early withdrawals from time certificates may deviate significantly from the assumptions used in the model. Finally, this methodology does not measure or reflect the impact that higher rates may have on adjustable-rate loan clients' ability to service their debt. All of these factors are considered in less formulaic ways in monitoring the Bank's exposure to interest rate risk.

Critical Accounting Policies

General

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (generally accepted accounting principles, or "GAAP"). The financial information contained within our consolidated financial statements is, to a significant extent, based on approximate measures of the financial effects of transactions and events that have already occurred. A variety of factors could affect the ultimate value that is obtained, either when earning income, recognizing an expense, recovering an asset or relieving a liability. In certain instances, we use a discount factor and prepayment assumptions to determine the present value of assets and liabilities. A change in the discount factor or prepayment speeds could increase or decrease the values of those assets and liabilities, which would result in either a beneficial or adverse impact to our financial results. We use historical loss factors as one factor in determining the inherent loss that may be present in our loan portfolio. Actual losses could differ significantly from the historical factors that we use. Other estimates that we use are related to the realization of our deferred tax assets and the expected useful lives of our depreciable assets. In addition, GAAP itself may change from one previously acceptable method to another, although the economics of our transactions would remain the same.

Fair Value of Securities

In accordance with GAAP, the Bank revalues the Available-for-Sale component of its investment portfolio on a quarterly basis, and records any unrealized gain or loss as an adjustment to other comprehensive income in its equity accounts. Held-to-Maturity securities are recorded at their amortized book value. The Bank also evaluates whether any of its security holdings are Other Than Temporarily Impaired ("OTTI"), but has determined that, as of December 31, 2019, none of its securities are deemed to be OTTI.

Allowance for Loan Losses

The allowance for loan losses is an estimate of the potential losses in our loan portfolio. Our accounting for estimated loan losses was previously discussed in this Item 7 under the heading, *"Allowance for Loan Losses."*

Deferred Tax Asset

Our net deferred tax asset arises from temporary differences between the carrying amount of assets and liabilities reported in the financial statements and the amounts used for income tax return purposes. Our accounting for Deferred Tax Asset was previously discussed under the heading "*Income Tax Expense*".

ITEM 7A. Quantitative and Qualitative Disclosures About Market Risk

As a financial institution, the Bank's primary component of market risk is interest rate volatility. Fluctuations in interest rates will ultimately impact both the level of income and expense recorded on most of the Bank's assets and liabilities and the market value of all interest-earning assets, other than those which have a short term to maturity. Based upon the nature of the Bank's operations, the Bank is not subject to significant direct foreign exchange or commodity price risks. The Bank has no market risk sensitive instruments, or any other financial instruments, that are held for trading purposes. As of December 31, 2019, the Bank did not use interest rate derivatives to hedge its interest rate risk.

The information concerning quantitative and qualitative disclosure about market risk called for by Item 305 of Regulation S-K is included as part of Item 7 of this Annual Report.

ITEM 8. Financial Statements and Supplementary Data

The response to this item is submitted as a separate section of this Annual Report. See Part IV, Item 15.

ITEM 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosures

As previously disclosed by the Company, on April 12, 2018, the Company engaged Squar Milner LLP ("Squar Milner") as its independent registered public accounting firm to audit the Company's consolidated financial statements, replacing Crowe Horwath LLP ("Crowe Horwath") who was dismissed on the same date. Crowe Horwath had served as the Company's independent registered public accounting firm since April 7, 2017.

At the time of Crowe Horwath's dismissal, in connection with the audit of the Company's financial statements for the year ended December 31, 2017, the Company and Crowe Horwath had been unable to agree regarding the adequacy of the Company's allowance and provision for loan and lease losses ("ALLL"), the sufficiency of the Company's access and change management controls related to the core operating system, the completeness and accuracy of system reports, and various other operational controls.

The Company is accounting for its ALLL differently than Crowe Horwath apparently would have required. The Company is unable to state the effect on its financial statements if such transaction had been accounted for in the manner which Crowe Horwath apparently would have concluded was required.

ITEM 9A. Controls and Procedures

Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports 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 rules and forms of the Securities and Exchange Commission (the "SEC"), and that such information is accumulated and communicated to our 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 a 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 in selecting those that we adopted.

In accordance with SEC rules, an evaluation was performed under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer of the effectiveness, as of December 31, 2019, of the Company's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15(e) and 15d-15(e). Based on such evaluation our Chief Executive Officer and our Chief Financial Officer concluded that, as of December 31, 2019, our disclosure controls and procedures were effective at the reasonable assurance level.

Internal Control Over Financial Reporting

Management's Annual Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) of the Exchange Act. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes those written policies and procedures that:

- pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of our assets;
- provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America;
- provide reasonable assurance that our receipts and expenditures are being made only in accordance with authorization of our management and Board of Directors; and,
- provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on our consolidated financial statements.

Internal control over financial reporting includes the controls themselves, monitoring and internal auditing practices, and actions taken to correct deficiencies as they are identified. Because of its inherent limitations, internal control over financial reporting may not prevent or detect all potential misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risks that controls may become inadequate because of changes in conditions or because the degree of compliance with the policies or procedures may deteriorate.

Management's Assessment of Internal Control Over Financial Reporting

Our management assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2019, based on criteria for effective internal control over financial reporting described in "*Internal Control – Integrated Framework (2013)*" issued by the Committee of Sponsoring Organizations of the Treadway Commission. Management's assessment included an evaluation of the design and the testing of the operational effectiveness of the Company's internal control over financial reporting. Based on management's assessment, management concluded that the Company's internal control over financial reporting was effective as of December 31, 2019.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the year ended December 31, 2019, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. Other Information

None.

PART III

ITEM 10. Directors, Executive Officers and Corporate Governance

Pursuant to General Instruction G(3) of Form 10-K, the information required by this Item 10 is incorporated by reference from the information contained in our Proxy Statement to be filed with the Securities and Exchange Commission in connection with the solicitation of proxies for our 2020 Annual Meeting of Stockholders (the “2020 Proxy Statement”) under the sections entitled “Board of Directors – Nominees for Directors,” “Executive Compensation – Executive Officers,” “Board of Directors – Committees, Membership and Meetings,” “Corporate Governance – Code of Ethics” and “Section 16(a) Beneficial Ownership Reporting Compliance.”

ITEM 11. Executive Compensation

The information required by this Item 11 is incorporated by reference from the information contained in our 2020 Proxy Statement under the sections entitled “Board of Directors – Committees, Membership and Meetings,” “Board of Directors – Director Compensation” and “Executive Compensation.”

ITEM 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information required by this Item 12 is incorporated by reference from the information contained in our 2020 Proxy Statement under the sections entitled “Beneficial Ownership of Common Stock” and “Executive Compensation – Equity Compensation Plan Information.”

ITEM 13. Certain Relationships and Related Transactions and Director Independence

The information required by this Item 13 is incorporated by reference from the information contained in our 2020 Proxy Statement under the sections entitled “Corporate Governance – Director Independence” and “Transactions with Related Persons.”

ITEM 14. Principal Accountant Fees and Services

The information required by this Item 14 is incorporated by reference from the information contained in our 2020 Proxy Statement under the section entitled “Ratification of Selection of Independent Registered Public Accounting Firm.”

PART IV

ITEM 15. Exhibits and Financial Statement Schedules

(a)(1) Financial Statements

The following financial statements are part of this report:

(a)(2) Financial Statement Schedules

All schedules to the Financial Statements are omitted because of the absence of the conditions under which they are required or because the required information is included in the Financial Statements or accompanying notes.

(b) Exhibits

The exhibit list required by this Item is incorporated by reference to the Exhibit Index included in this report.

		Incorporated by Reference			
Exhibit No.	**Exhibit Description**	**Form**	**Exhibit**	**Filing Date**	**Filed Herewith**
3.01	Second Amended and Restated Articles of Incorporation of BankGuam Holding Company (including Certificate of Designation of 5.50% Fixed Rate/Floating Rate Noncumulative Preferred Stock, Series A, of BankGuam Holding Company)	8-K (File No. 000-54483)	3.1	August 26, 2016	
3.02	First Amended By-Laws of BankGuam Holding Company	10-Q (File No. 000-54483)	3.03	November 13, 2012	
9.01	Voting Trust Agreement dated November 29, 2013 between certain shareholders of BankGuam Holding Company and Lourdes A. Leon Guerrero, as Trustee	10-K (File No. 000-54483)	9.02	March 17, 2014	
10.01	Stock Purchase Agreement dated May 27, 2016 between David J. John and BankGuam Holding Company	8-K (File No. 000-54483)	10.01	January 17, 2017	
10.02*	Employment Agreement dated January 11, 2017 between Bank of Guam and Francisco M. Atalig	8-K (File No. 000-54483)	10.07	January 17, 2017	
10.03*	Exhibits A and B to the Employment Agreement dated January 11, 2017 between Bank of Guam and Francisco M. Atalig	8-K/A (File No. 000-54483)	10.07	January 20, 2017	
10.04*	Employment Agreement dated June 27, 2013 between Bank of Guam and William D. Leon Guerrero	10-K (File No. 000-54483)	10.02	March 17, 2014	
10.05*	Agreement to Extend Employment Agreement dated May 29, 2018 between William D. Leon Guerrero and Bank of Guam	10-K (File No. 000-54483)	10.08	June 29, 2018	
10.06*	Employment Agreement dated April 1, 2019 between Joaquin P.L.G. Cook and Bank of Guam	10-Q (File No. 000-54483)	10.01	May 10, 2019	
10.07*	Employment Agreement dated April 1, 2019 between Maria Eugenia H. Leon Guerrero and Bank of Guam	10-Q (File No. 000-54483)	10.02	May 10, 2019	

10.08*	BankGuam Holding Company 2011 Amended and Restated Employee Stock Purchase Plan	S-8 (File No. 333-182615)	99.1	July 11, 2012	
10.09*	BankGuam Holding Company Stock Service Award Plan	S-8 (File No. 333-196854)	99.1	June 18, 2014	
21.01	List of Significant Subsidiaries of the Company	S-1 (File No. 333-220357)	21.01	September 6, 2017	
23.01	Consent of Independent Registered Public Accounting Firm				X
31.01	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act - Joaquin P.L.G. Cook				X
31.02	Certification Pursuant to Section 302 of the Sarbanes-Oxley Act – Francisco M. Atalig				X
32.01	Certification Pursuant to Section 906 of the Sarbanes-Oxley Act				X
101	Interactive Data Files Pursuant to Rule 405 of Regulation S-T: (i) Consolidated Statements of Financial Condition as of December 31, 2019 and 2018, (ii) Consolidated Statements of Income for the years ended December 31, 2019 and 2018, (iii) Consolidated Statements of Comprehensive Income for the years ended December 31, 2019 and 2018; (iv) Consolidated Statements of Stockholders' Equity for the years ended December 31, 2019 and 2018; (v) Consolidated Statements of Cash Flows for the years ended December 31, 2019 and 2018; and (vi) Notes to Consolidated Financial Statements				X

* Management contract or compensatory plan or arrangement.

ITEM 16. Form 10-K Summary

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report on Form 10-K to be signed on its behalf by the undersigned thereunto duly authorized.

BANKGUAM HOLDING COMPANY

BY: /s/ JOAQUIN P.L.G. COOK
Joaquin P.L.G. Cook
President and Chief Executive Officer

DATE: March 19, 2020

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated:

Name	Title	Date
/s/ JOAQUIN P.L.G. COOK Joaquin P.L.G. Cook	Director, President and Chief Executive Officer (Principal Executive Officer)	March 19, 2020
/s/ FRANCISCO M. ATALIG Francisco M. Atalig	Chief Financial Officer (Principal Financial Officer)	March 19, 2020
/s/ SYMON A. MADRAZO Symon A. Madrazo	Controller (Controller)	March 19, 2020
/s/ WILLIAM D. LEON GUERRERO William D. Leon Guerrero	Chair of the Board	March 19, 2020
/s/ MARIA EUGENIA H. LEON GUERRERO Maria Eugenia H. Leon Guerrero	Executive Vice President and Director	March 19, 2020
/s/ ROGER P. CROUTHAMEL Roger P. Crouthamel	Corporate Secretary and Director	March 19, 2020
/s/ MARTIN D. LEON GUERRERO Martin D. Leon Guerrero	Treasurer, Assistant Corporate Secretary and Director	March 19, 2020
/s/ PATRICIA P. ADA Patricia P. Ada	Director	March 19, 2020
/s/ FRANCES L.G. BORJA Frances L.G. Borja	Director	March 19, 2020
/s/ Keven F. CAMACHO Keven F. Camacho	Director	March 19, 2020
/s/ JOSEPH CRISOSTOMO Joseph Crisostomo	Director	March 19, 2020
/s/ Mark J. SABLAN Mark J. Sablan	Director	March 19, 2020
/s/ JOHN S. SAN AGUSTIN John S. San Agustin	Director	March 19, 2020

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Stockholders and the Board of Directors of BankGuam Holding Company.

Opinion on the Financial Statements

We have audited the accompanying consolidated statements of financial condition of BankGuam Holding Company and subsidiaries (the Company) as of December 31, 2019 and 2018, the related consolidated statements of income, comprehensive income, stockholders' equity and cash flows for the years then ended, and the related notes to the consolidated financial statements (collectively, the financial statements). In our opinion, the financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2019 and 2018, and the results of its operations and its cash flows for each of the two years in the period ended December 31, 2019, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the Company’s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Squar Milner LLP

We have served as the Company’s auditor since 2011.

San Diego, California

March 19, 2020

BankGuam Holding Company
Consolidated Statements of Financial Condition
(Dollar and Share Amounts in Thousands, Except Par Value)

	December 31, 2019	December 31, 2018
ASSETS		
Cash and due from banks	$ 37,870	$ 33,279
Interest bearing deposits in banks	93,846	121,816
Total cash and cash equivalents	131,716	155,095
Restricted cash	400	400
Investment in unconsolidated subsidiary	7,443	3,291
Investment securities available-for-sale, at fair value	377,130	381,042
Investment securities held-to-maturity, at amortized cost (Fair Value $50,204 at 12/31/19 and $67,477 at 12/31/18)	49,984	68,088
Federal Home Loan Bank stock, at cost	2,267	2,356
Loans, net of allowance for loan losses ($27,870 at 12/31/19 and $23,774 at 12/31/18)	1,275,272	1,212,141
Accrued interest receivable	5,581	6,221
Premises and equipment, net	19,754	18,471
Other assets	83,515	44,597
Total assets	$ 1,953,062	$ 1,891,702
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Deposits:		
Non-interest bearing	$ 582,967	$ 538,168
Interest bearing	1,146,939	1,190,655
Total deposits	1,729,906	1,728,823
Accrued interest payable	118	137
Subordinated debt, net	14,751	-
Other liabilities	44,044	14,447
Total liabilities	1,788,819	1,743,407
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Common stock $0.2083 par value; 48,000 shares authorized; 9,704 and 9,679 shares issued and 9,672 and 9,646 shares outstanding at 12/31/19 and 12/31/18, respectively	2,023	2,017
Preferred stock $100 par value; 300 shares authorized; 9.8 shares issued and outstanding	980	980
Additional paid-in capital, Common stock	24,478	24,214
Additional paid-in capital, Preferred stock	8,803	8,803
Retained earnings	129,576	117,339
Accumulated other comprehensive loss	(1,327)	(4,768)
Common stock in treasury, at cost (32 shares)	(290)	(290)
Total stockholders' equity	164,243	148,295
Total liabilities and stockholders' equity	$ 1,953,062	$ 1,891,702

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

BankGuam Holding Company
Consolidated Statements of Income
(Dollar and Share Amounts in Thousands, Except Per Share Amounts)

	Years Ended December 31, 2019	2018
Interest income:		
Loans	$ 81,013	$ 79,158
Investment securities	9,674	9,682
Deposits with banks	2,218	1,202
Total interest income	92,905	90,042
Interest expense:		
Savings deposits	1,902	1,995
Time deposits	107	115
Other borrowed funds	485	10
Total interest expense	2,494	2,120
Net interest income	90,411	87,922
Provision for loan losses	9,788	12,862
Net interest income, after provision for loan losses	80,623	75,060
Non-interest income:		
Service charges and fees	6,719	6,550
Gains (losses) on sale of investment securities	347	(593)
Income from merchant services, net	2,338	2,385
Cardholders income, net	1,836	1,230
Trustee fees	2,673	2,548
Other income	3,766	3,599
Total non-interest income	17,679	15,719
Non-interest expense:		
Salaries and employee benefits	36,342	36,654
Occupancy	8,455	7,339
Equipment and depreciation	11,377	10,142
Insurance	1,878	1,759
Telecommunications	1,394	1,959
FDIC assessment	889	1,330
Professional services	2,492	2,686
Contract services	2,028	1,759
Other real estate owned	1,237	696
Stationery and supplies	802	855
Training and education	997	1,062
General, administrative and other	8,659	8,786
Total non-interest expense	76,550	75,027
Income before income taxes	21,752	15,752
Income tax expense	5,601	2,913
Net income	16,151	12,839
Preferred stock dividend	(547)	(546)
Net income attributable to common stockholders	$ 15,604	$ 12,293
Earnings per common share:		
Basic	$ 1.62	$ 1.28
Diluted	$ 1.62	$ 1.28
Dividends declared per common share	$ 0.40	$ 0.40
Basic weighted average common shares	9,657	9,614
Diluted weighted average common shares	9,657	9,614

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

BankGuam Holding Company
Consolidated Statements of Comprehensive Income
(Dollar Amounts in Thousands)

	Years Ended December 31,	
	2019	2018
Net income	$ 16,151	$ 12,839
Other comprehensive income (loss):		
Unrealized holding gain (loss) on available-for-sale securities arising during the period, net of tax	3,449	(2,235)
Reclassification for (gain) loss realized on available-for-sale securities	(347)	593
Amortization of post-transfer unrealized holding loss on held-to-maturity securities during the period, net of tax	339	561
Total other comprehensive income (loss)	3,441	(1,081)
Total comprehensive income	$ 19,592	$ 11,758

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

BankGuam Holding Company
Consolidated Statements of Stockholders' Equity
(Dollar Amounts in Thousands, Except Number of Shares)

	Number of Common Shares	Common Stock	Preferred Stock	Additional Paid-in Capital - Common	Additional Paid-in Capital - Preferred	Retained Earnings	Accumulated Other Comprehensive loss	Treasury Stock	Total
Balances, December 31, 2017	9,413,958	$ 1,969	$ 980	$ 21,472	$ 8,803	$ 108,900	$ (3,687)	$ (290)	$ 138,147
Comprehensive income:									
Net income	-	-	-	-	-	12,839	-	-	12,839
Change in accumulated other comprehensive income:									
Unrealized gain on available-for-sale securities	-	-	-	-	-	-	(1,081)	-	(1,081)
Common stock issued under Employee Stock Purchase Plan & Service Awards	14,563	3	-	145	-	-	-	-	148
Common stock issued	217,823	45	-	2,597	-	-	-	-	2,642
Cash dividends on common stock	-	-	-	-	-	(3,854)	-	-	(3,854)
Cash dividends on preferred stock	-	-	-	-	-	(546)	-	-	(546)
Balances, December 31, 2018	9,646,344	2,017	980	24,214	8,803	117,339	(4,768)	(290)	148,295
Comprehensive income:									
Net income	-	-	-	-	-	16,151	-	-	16,151
Reclassification related to adoption of new accounting standard	-	-	-	-	-	496	-	-	496
Change in accumulated other comprehensive income:									
Unrealized gain on available-for-sale securities	-	-	-	-	-	-	3,441	-	3,441
Common stock issued under Employee Stock Purchase Plan & Service Awards	25,212	6	-	264	-	-	-	-	270
Cash dividends on common stock	-	-	-	-	-	(3,863)	-	-	(3,863)
Cash dividends on preferred stock	-	-	-	-	-	(547)	-	-	(547)
Balances, December 31, 2019	9,671,556	$ 2,023	$ 980	$ 24,478	$ 8,803	$ 129,576	$ (1,327)	$ (290)	$ 164,243

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

BankGuam Holding Company
Consolidated Statements of Cash Flows
(Dollar Amounts in Thousands)

	Years Ended December 31, 2019	2018
Cash flows from operating activities:		
Net income	$ 16,151	$ 12,839
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for loan losses	9,788	12,862
Depreciation	3,905	3,640
Amortization of debt issuance costs	(249)	-
Amortization of fees, discounts and premiums	810	1,263
Loss on sales of other real estate owned, net	(26)	(34)
Proceeds from sales of loans held for sale	20,148	5,670
Origination of loans held for sale	(20,148)	(5,670)
Increase in mortgage servicing rights	74	125
(Gains) losses on sale of investment securities	(347)	593
Realized gains (losses) on sale of premises and equipment	35	(9)
Noncash lease expense	2,674	-
Net change in operating assets and liabilities:		
Accrued interest receivable	640	(493)
Other assets	(9,147)	5,250
Accrued interest payable	(19)	6
Lease liability	(2,209)	-
Other liabilities	(562)	2,911
Net cash provided by operating activities	21,518	38,953
Cash flows from investing activities:		
Increased investment in unconsolidated subsidiary	(4,090)	-
Purchases of available-for-sale securities	(145,068)	(88,496)
Proceeds from sales of available-for-sale securities	50,094	94,752
Maturities, prepayments and calls of available-for-sale securities	101,769	70,392
Maturities, prepayments and calls of held-to-maturity securities	18,200	21,750
Loan originations and principal collections, net	(72,974)	(15,297)
Income from equity investment in unconsolidated subsidiary	(683)	(527)
Dividends received from unconsolidated subsidiary	621	403
Proceeds (costs) of FHLB stock purchase	89	(53)
Proceeds from sales of other real estate owned	390	280
Proceeds from sales of premises and equipment	44	9
Purchases of premises and equipment	(5,232)	(4,279)
Net cash (used in) provided by investing activities	(56,840)	78,934
Cash flows from financing activities:		
Net increase (decrease) in deposits	1,083	(87,309)
Proceeds from issuance of subordinated debt, net	15,000	-
Proceeds from issuance of common stock	270	2,790
Dividends paid	(4,410)	(4,400)
Net cash provided by (used in) financing activities	11,943	(88,919)
Net change in cash, cash equivalents and restricted cash	(23,379)	28,968
Cash, cash equivalents and restricted cash at beginning of period	155,495	126,527
Cash, cash equivalents and restricted cash at end of period	$ 132,116	$ 155,495
Supplemental disclosure of cash flow information:		
Cash paid during the period for:		
Interest	$ 1,891	$ 2,103
Income taxes	$ 5,070	$ 3,979
Supplemental disclosure of noncash investing and financing activities:		
Net change in unrealized loss on held-to-maturity securities, net of tax	$ 339	$ 561
Net change in unrealized gain (loss) on available-for-sale securities, net of tax	$ 3,102	$ (1,643)
Other real estate owned transferred to loans, net	$ (55)	$ (118)
Initial recognition of right-of-use asset	$ 32,572	$ -
Initial recognition of lease liability	$ (32,369)	$ -

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

Note 1 – Nature of Business

Organization

The accompanying consolidated financial statements include the accounts of BankGuam Holding Company ("Company") and its wholly-owned subsidiaries, Bank of Guam ("Bank") and BankGuam Investment Services ("BGIS") (formerly BankGuam Investment and Insurance Services). The Company is a Guam corporation organized on October 29, 2010, to act as the holding company of the Bank, a Guam banking corporation, a 22-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. BankGuam Investment Services was incorporated in Guam in 2015 and initially capitalized during the first quarter of 2016. During July 2016, the Company executed an agreement to purchase up to 70% of ASC Trust LLC, formerly ASC Trust Corporation, which has resulted in the Company purchasing 45% of the voting common stock of ASC Trust LLC to date.

Other than holding the shares of the Bank, BGIS and ASC Trust LLC, 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 eleven branches in Guam, four in the CNMI, four in the FSM, one in the RMI, one in the ROP, and one in San Francisco, California. The Bank's primary deposit products are demand deposits, savings and time certificate accounts, and its primary lending products are consumer, commercial and real estate loans. On January 15, 2020 the FDIC notified the Bank that they have no objections to the closure of the Tumon and Malesso branches in Guam effective April 3, 2020.

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

Note 2 – Summary of Significant Accounting Policies

Principles of Consolidation and Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with generally accepted accounting principles in effect in the United States ("GAAP"), on a basis consistent with prior periods. Certain prior period amounts have been reclassified to conform to current year presentation.

The consolidated financial statements include the accounts of BankGuam Holding Company, the Bank, BGIS, and the Bank's wholly owned subsidiaries, BankGuam Properties, Inc. and BankGuam Insurance Underwriters, Ltd. All significant intercompany and inter-branch balances and transactions have been eliminated in consolidation.

Assets held by the Bank's Trust Department and its sister corporation, BankGuam Investment Services, in a fiduciary capacity are not assets of the Bank, and, accordingly, are not included in the accompanying consolidated financial statements.

The Company's investment in ASC Trust LLC is accounted for under the equity method of accounting.

Use of Estimates

The preparation of consolidated financial statements in accordance with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and 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.

Cash Flows

Net cash flows are reported for customer loan and deposit transactions, notes payable and other short-term borrowings.

Cash and Cash Equivalents

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand and balances due from banks, Federal Funds sold, cash items in transit and interest bearing deposits with other banks. The Bank is required by the Federal Reserve System to maintain cash reserves against certain of its deposit accounts. At December 31, 2019 and 2018, the required combined reserves totaled approximately $40.7 million and $39.2 million, respectively.

Restricted Cash

Interest-bearing deposits in banks that mature within one year are carried at cost. $150 thousand of these deposits are held by the Bank jointly under the names of Bank of Guam and the Guam Insurance Commissioner, and serve as a bond for the Bank of Guam Trust Department, and $250 thousand of these deposits are held by the Bank of Guam and are pledged for the Banker's Loan Processing (BLP) program with one of its correspondent banks in San Francisco.

Investment Securities

Certain debt securities that management has the positive intent and ability to hold to maturity are classified as "held-to-maturity," and are recorded at amortized cost. Securities not classified as held-to-maturity, including equity securities with readily determinable fair value, are classified as "available-for-sale" and are recorded at fair value, with unrealized gains and losses excluded from earnings and reported in other comprehensive income. Purchase premiums and discounts are recognized in interest income using the interest method over the terms of the securities. Gains and losses on the sale of securities are recorded on the trade date and are determined using the specific identification method. The Bank does not hold securities for trading purposes.

Declines in the fair value of securities below their cost that are other than temporary are reflected in earnings as realized losses. In determining other-than-temporary losses, management considers many factors, including: (1) the length of time and the extent to which the fair value has been less than cost, (2) the financial condition and near-term prospects of the issuer, (3) whether the market decline was affected by macroeconomic conditions, and (4) whether the entity has the intent to sell the debt security or more likely than not will be required to sell the debt security before its anticipated recovery. The assessment of whether an other-than-temporary decline exists involves a high degree of subjectivity and judgment, and is based on the information available to management at the time such a determination is made.

Federal Home Loan Bank Stock

The Bank is required to hold non-marketable equity securities, comprised of Federal Home Loan Bank of Des Moines ("FHLB") stock, as a condition of membership. These securities are accounted for at cost, which equals par or redemption value. Ownership is restricted and there is no market for these securities. These securities are redeemable at par by the issuing government supported institutions. The primary factor supporting the carrying value is the commitment of the FHLB to perform its obligations, which includes providing credit and other services to the Bank.

Mortgage Servicing Rights (MSR)

Mortgage servicing assets, included in other assets in the consolidated statements of financial condition, are recognized separately when rights are acquired through the sale of mortgage loans. Under the servicing assets and liabilities accounting guidance in ASC Topic 860, "*Transfers and Servicing*", servicing rights resulting from the sale of loans originated by the Bank are measured at fair value at the date of transfer. The Bank subsequently measures each class of servicing assets using the fair value method. Under the fair value method, the servicing rights are carried in the statements of financial condition at fair value and the changes in fair value are reported in earnings in the period in which the changes occur. Servicing fee income is recorded as fees earned for servicing loans. The fees are based on a contractual percentage of the outstanding principal, and are recorded as income when earned.

Loans Held for Investment

Loans held for investment generally are reported at their outstanding unpaid principal balances, adjusted for charge-offs, an allowance for loan losses, and any deferred fees or costs on the originated loans, as well as unamortized premiums or discounts on purchased loans, except for certain purchased loans that fall under the scope of Accounting Standards Codification (ASC) Topic 310-30, "*Accounting for Loans and Debt Securities Acquired with Deteriorated Credit Quality*".

Interest income is accrued on the unpaid principal balance of loans. Loan origination fees, net of certain direct origination costs, are deferred and recognized as income using the effective interest method over the contractual life of the loans. The accrual of interest on mortgage and commercial loans is discontinued at the time the loan is 90 days past due unless the credit is well-secured and in process of collection. Credit card loans and other unsecured consumer loans are typically charged off no later than when they are 180 days past due. Past due status is based on the contractual terms of the loan. In all cases, loans are placed on non-accrual or charged-off at an earlier date if collection of principal or interest is considered doubtful.

All interest accrued but not collected for loans that are placed on non-accrual or charged-off are reversed against current period interest income. The interest on these loans is accounted for on the cash-basis or cost-recovery method, until qualifying for return to accrual. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current and future payments are reasonably assured.

Loan Origination Fees and Costs

All loan origination fees and related direct costs are deferred and amortized to interest income as an adjustment to yield over the respective lives of the loans using the effective interest method, except for loans that are revolving or short-term in nature for which the straight line method is used, which approximates the interest method.

Allowance for Loan Losses, Impaired Loans and Troubled Debt Restructurings

The allowance for loan losses is established as losses are estimated to be likely, and is funded through a provision for loan losses charged to earnings. Loan losses are charged against the allowance when management believes the uncollectability of a loan is confirmed. Subsequent recoveries, if any, are credited to the allowance.

The allowance for loan losses is first determined by analyzing all classified loans (Substandard and Doubtful) in non-accrual for loss exposure and establishing specific reserves, as needed. ASC 310-10 defines loan impairment as the existence of uncertainty concerning collection of all principal and interest per the contractual terms of a loan. For collateral-dependent loans, impairment is typically measured by comparing the loan amount to the fair value of collateral, less costs to sell, with a specific reserve established for the “shortfall” amount. Other methods can be used in estimating impairment (market price or present value of expected future cash flows discounted at the loan’s original interest rate).

The allowance for loan losses is management’s estimate of credit losses inherent in the loan portfolio at the balance sheet date. The Company has established a process to determine the appropriateness of the allowance for credit losses that assesses the losses inherent in the loan portfolio. The Company develops and documents its allowance methodology at the portfolio segment level – commercial loan, residential mortgage and consumer loan portfolios. While portions of the allowance are attributable to the respective commercial, residential mortgage and consumer portfolio segments, the entire allowance is available to absorb credit losses inherent in the total loan portfolio.

The allowance for loan losses is evaluated on a regular basis by 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.

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. 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.

In situations where, for economic or legal reasons related to a borrower’s financial difficulties, the Bank will grant a concession for other than an insignificant period of time to the borrower that would not otherwise be considered, the related loan is classified as a troubled debt restructuring (TDR). These modified terms may include rate reductions, principal forgiveness, term extensions, payment forbearance and other actions intended to minimize economic loss and to avoid foreclosure or repossession of the collateral, if applicable. For modifications where principal is forgiven, the entire amount of such principal forgiveness is immediately charged off. Loans classified as TDRs, including loans in trial payment periods (trial modifications), are considered impaired loans. Other than resolutions such as foreclosures, the Bank may remove loans held for investment from TDR classification, but only if they have been refinanced or restructured at market terms and qualify as a new loan.

Loans Held for Sale

In its normal course of business, the Bank originates mortgage loans held for sale to 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. The Bank recognizes gains on the sale of loans sold to Freddie Mac only to the extent of MSRs retained in such sales.

During the years ended December 31, 2019 and 2018, the Bank originated and sold approximately $20.1 million and $5.7 million, respectively, of the above-mentioned loans.

Off-Balance Sheet Financial Instruments

In the ordinary course of business, the Bank has entered into commitments to extend credit, including commitments under credit card arrangements, commercial letters of credit and standby letters of credit. Such financial instruments are recorded as off-balance sheet items when the commitment is made, then recorded as balance sheet items if and when funded (See Note 16).

Premises and Equipment

Premises and equipment are reported at cost, less accumulated depreciation and amortization. Depreciation and amortization are computed on the straight-line method over the estimated useful lives of the related assets. Depreciation expense has been computed principally using estimated lives of 15 to 40 years for premises and 3 to 10 years for furniture and equipment. Leasehold improvements are depreciated over the estimated lives of the assets or the expected terms of the leases, if shorter. Expected terms include lease option periods to the extent that the exercise of such options is reasonably assured.

Construction-in-progress consists of accumulated direct and indirect costs associated with the Bank's construction of premises and the purchase of equipment that has not yet been placed in service and, accordingly, has not yet been subjected to depreciation. Such assets begin depreciation over their estimated useful lives when completed and placed in service.

Premises and equipment are periodically evaluated for impairment when events or changes in circumstances indicate the carrying amount may not be recoverable. Impairment exists when the expected undiscounted future cash flows of premises and equipment are less than their carrying amount. In that event, the Bank records a loss for the difference between the carrying amount and the estimated fair value of the asset based on appraised values or quoted prices.

Other Real Estate Owned

Properties acquired through, or in lieu of, loan foreclosure are held for sale and are initially recorded at the fair value of the property, reduced by estimated selling costs. Subsequent to foreclosure, valuations are periodically performed by management and the assets are carried at the lower of carrying amount or fair value, less the estimated cost to sell. Other real estate owned is estimated using the appraised value of the underlying collateral, discounted as necessary due to management's estimates of changes in economic conditions, less estimated costs to sell. A valuation allowance is increased by provisions charged to earnings. Subsequent write-downs, income and expenses incurred in connection with holding such assets, and gains and losses realized from the sale of such assets, are charged to the valuation allowance.

Goodwill

Goodwill is recorded in business combinations under the purchase method of accounting when the purchase price is greater than the fair value of net assets, including identifiable intangible assets. The Bank will assess goodwill for impairment at a reporting unit level on an annual basis or more frequently in certain circumstances. The Bank has the option of performing a qualitative assessment of goodwill, or to bypass the qualitative test and proceed directly to a quantitative test. If the Bank performs a qualitative assessment of goodwill to test for impairment and concludes it is more likely than not that a reporting unit's fair value is greater than its carrying amount, quantitative tests are not required. However, if it is determined it is more likely than not that a reporting unit's fair value is less than its carrying amount, then the Bank completes a quantitative assessment to determine if there is goodwill impairment. The Bank can apply various quantitative valuation methodologies, including discounted cash flow and earnings multiple approaches, to determine the estimated fair value, which is compared to the carrying value of each reporting unit. If the fair value is less than the carrying amount, an additional test is required to measure the amount of impairment. Based on the Bank's year-end evaluation, no goodwill impairment was recorded.

Income Taxes

Income taxes represent taxes recognized under laws of the Government of Guam, which generally conform to U.S. income tax laws. Foreign income taxes result from payments of taxes with effective rates ranging from 2% to 5% of gross income in the FSM, the RMI and the ROP to their respective government jurisdictions. U.S. Federal, California and the Commonwealth of the Northern Mariana Islands income taxes are reflected as foreign taxes for financial reporting purposes.

The income tax accounting guidance results in two components of income tax expense: current and deferred. Current income tax expense reflects taxes to be paid for the period by applying the provisions of the enacted tax law to the taxable income. The Company determines deferred income taxes using the liability (or balance sheet) method. Under this method, the net deferred tax asset or liability is based on the tax effects of the differences between the book and tax bases of assets and liabilities, and enacted changes in tax rates and laws are recognized in the period in which they occur.

Deferred income tax expense results from changes in deferred tax assets and liabilities between periods. Deferred tax assets are recognized if it is more likely than not, based on the technical merits, that the tax position will be realized or sustained upon examination. The term, “more likely than not,” means a likelihood of more than 50 percent; the terms, “examined,” and, “upon examination,” also include resolution of related appeals or litigation processes, if any. Deferred tax assets are reduced by a valuation allowance if, based on the weight of evidence available, it is more likely than not that some portion or all of a deferred tax asset will not be realized.

Uncertain tax positions that meet the more likely than not recognition threshold are measured to determine the amount of benefit to recognize. An uncertain tax position is measured at the largest amount of benefit that management believes has a greater than 50% likelihood of realization upon settlement. The Company recognizes interest and penalties on income taxes as a component of income tax expense.

Earnings Per Common Share

Basic earnings per share represent income available to common stockholders (after deducting dividends on preferred stock) 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 have been issued by the Company relate solely to outstanding stock options, and are determined using the treasury stock method.

Fair Value of Financial Instruments/Fair Value Option

Fair values of financial instruments are estimated using relevant market information and other assumptions, as more fully disclosed in Note 19. Fair value estimates involve uncertainties and matters of significant judgment. Changes in assumptions or in market conditions could significantly affect these estimates. In addition, the fair value option provides an option to elect fair value as an alternative measurement for selected financial assets, financial liabilities, unrecognized firm commitments and written loan commitments not previously carried at fair value. The Company and the Bank have elected the fair value option for its mortgage servicing rights. The election was made to better reflect the underlying economics and to mitigate operational complexities in risk management activities.

Transfers of Financial Assets

Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when, (i) the assets have been isolated from the Bank – put presumptively beyond the reach of the transferor and its creditors, even in bankruptcy or other receivership, (ii) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (iii) the Bank does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity or the ability to unilaterally cause the holder to return specific assets.

Contingencies

From time to time, the Company may become involved in disputes, litigation and other legal actions. In such event, the Company estimates the range of liability related to pending litigation where the amount and range of loss can be estimated and information available prior to the issuance of financial statements indicates such loss is considered probable. Where a liability is probable and there is a range of estimated loss with no best estimate in the range, the Company records a charge equal to at least the minimum amount in the range.

Subsequent Events

Subsequent events are events or transactions that occur after the balance sheet date but before financial statements are issued (See Note 23). The Company recognizes in the financial statements the effects of all subsequent events that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing the financial statements. The Company’s financial statements do not recognize subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date and before financial statements are available to be issued.

The Company has evaluated subsequent events through the date that these consolidated financial statements are being filed with the Securities and Exchange Commission.

Note 3 – Recent Accounting Pronouncements

Recently Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU 2016-02, *"Leases (Topic 842)"*, a new Topic which, as modified by ASU 2018-10 and ASU 2018-12, is intended to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements on the basis that it is important that users of financial statements have a complete and understandable picture of an entity's leasing activities. These ASUs were effective January 1, 2019, with early adoption permitted. The Company adopted ASC 842 on its effective date and has elected to not restate prior periods, presenting the cumulative effect of applying the new standard within the opening balance of retained earnings on January 1, 2019. The new standard allows for several transition practical expedients. The Company has chosen to elect the package of practical expedients, which permits the Company to forgo reassessing lease identification, lease classification, and initial direct costs. The Company will apply the hindsight practical expedient when evaluating the lease term and assessing impairment of Right of Usage ("ROU") assets. The Company also elected to combine the lease and non-lease components, such as maintenance fees, as a single lease component and elected to use the remaining lease term instead of total lease term in determining the incremental borrowing rate. The Company has made an accounting policy election to not recognize lease liabilities and ROU assets for short-term leases, which are leases with initial terms of 12 months or less and for which there is not a purchase option that is reasonably certain to be exercised. All leases within the Company's portfolio are classified as operating leases. On adoption, the Company recognized ROU assets and lease liabilities for operating leases of $32.6 million and $32.4 million, respectively, with no cumulative effect in retained earnings, which are included in other assets and other liabilities on the accompanying consolidated statements of financial condition.

In February 2018, the FASB issued ASU 2018-02, "*Income Statement – Reporting Comprehensive Income (Topic 220)*". This update allows a reclassification for stranded tax effects related to the Tax Cuts and Jobs Act of December 22, 2017, and is intended to improve the usefulness of information reported to the users of financial statements. The effective date of this update is for fiscal years beginning after December 15, 2018. Although adoption of this standard is not required of the Company until January 1, 2020, early adoption is permitted. The Company adopted this standard on January 1, 2019, and reclassified $496 thousand from deferred tax asset to retained earnings at March 31, 2019.

Recently Issued but Not Yet Adopted Accounting Pronouncements

In June 2016, the FASB issued ASU 2016-13, *"Financial Instruments – Credit Losses (Topic 326)"*, to amend the standards for the measurement of credit losses on financial instruments by replacing the historical incurred loss impairment methodology of determining the level of the allowance for loan and lease losses (ALLL), including losses associated with held-to-maturity securities, with a more decision-useful methodology that reflects expected credit losses over the life of a financial instrument based upon historical experience, current conditions, and reasonable and supportable forecasts in determining the ALLL level, as well as the reserve for off-balance-sheet credit exposures. The Company was preparing to implement ASU 2016-13 when it was scheduled to become effective January 1, 2020, but the FASB announced on October 16, 2019, a delay of the effective date for smaller reporting companies until January 1, 2023. Management expects to recognize a one-time cumulative effect adjustment to the allowance for loan losses as of the first reporting period in which the new standard is effective, but cannot yet estimate the magnitude of the adjustment or the overall impact of the new guidance on the Company's financial position, results of operations or cash flows.

Note 4 – Interest-Bearing Deposits and Restricted Cash

The Company had $94.2 million and $122.2 million in interest bearing deposits, including restricted cash, at other financial institutions at December 31, 2019 and 2018, respectively. The weighted average percentage yields on these deposits were 1.55% and 2.40% at December 31, 2019 and 2018, respectively. Interest bearing deposits with financial institutions can be withdrawn by the Bank on demand, and are considered cash equivalents for purposes of the consolidated statements of financial condition and cash flows.

At both December 31, 2019 and 2018, we had $400 thousand of restricted cash held in time deposits that were scheduled to mature within one year. Of these deposits, $150 thousand are held by the Bank jointly under the names of Bank of Guam and the Guam Insurance Commissioner, and serve as a bond for the Bank of Guam Trust Department, and $250 thousand are held by Bank of Guam, and are pledged for Banker's Loan Processing (BLP) program with Pacific Coast Bankers Bank in California. The weighted average percentage yields on these restricted cash deposits were 1.86% and 1.49% at December 31, 2019 and 2018, respectively.

Note 5 – Investment Securities

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

	December 31, 2019			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ 75,496	$ 3	$ (64)	$ 75,435
U.S. government agency pool securities	174,543	42	(1,088)	173,497
U.S. government agency or GSE residential mortgage-backed securities	128,409	181	(392)	128,198
Total	$ 378,448	$ 226	$ (1,544)	$ 377,130
Securities Held-to-Maturity				
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ 31,723	$ 286	$ (1)	$ 32,008
U.S. government agency pool securities	5,727	6	(70)	5,663
U.S. government agency or GSE residential mortgage-backed securities	12,534	67	(68)	12,533
Total	$ 49,984	$ 359	$ (139)	$ 50,204

	December 31, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Securities Available-for-Sale				
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ 100,497	$ -	$ (1,587)	$ 98,910
U.S. government agency pool securities	213,055	24	(1,707)	211,372
U.S. government agency or GSE residential mortgage-backed securities	72,735	-	(1,975)	70,760
Total	$ 386,287	$ 24	$ (5,269)	$ 381,042
Securities Held-to-Maturity				
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ 38,445	$ 46	$ (88)	$ 38,403
U.S. government agency pool securities	9,089	3	(80)	9,012
U.S. government agency or GSE residential mortgage-backed securities	20,554	29	(521)	20,062
Total	$ 68,088	$ 78	$ (689)	$ 67,477

At December 31, 2019 and 2018, investment securities with a carrying value of $299.5 million and $282.4 million, respectively, were pledged to secure various government deposits and other government requirements.

Proceeds and gross realized gains (losses) from the sales or calls of investment securities for the years ended December 31, 2019 and 2018, are shown below:

	Years Ended December 31,	
	2019	2018
Proceeds from sales	$ 50,094	$ 94,752
Gross realized gains from sales	$ 347	$ -
Gross realized losses from sales	$ -	$ (593)

The amortized cost and estimated fair value of investment securities by contractual maturity at December 31, 2019 and 2018, are shown below. Actual maturities may differ from contractual maturities because issuers may have the right to call or borrowers the right to prepay obligations with or without call or prepayment penalties. At December 31, 2019, obligations of U.S. government corporations and agencies with amortized costs totaling $428.4 million consist predominantly of Small Business Administration agency pool securities totaling $180.3 million and residential mortgage-backed securities totaling $140.9 million whose contractual maturity, or principal repayment, will follow the repayment of the underlying small business loans or mortgages. For purposes of the following table, the entire outstanding balance of these SBA Pools and mortgage-backed securities issued by U.S. government corporations and agencies is categorized based on final maturity date. At December 31, 2019, the Bank estimates the average remaining life of these SBA Pools and mortgage-backed securities to be approximately 2.7 years and 4.0 years, respectively.

	December 31, 2019			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	$ 55,022	$ 54,980	$ 19,840	$ 19,982
Due after one but within five years	26,868	26,838	14,680	14,796
Due after five but within ten years	101,390	101,252	7,172	7,211
Due after ten years	195,168	194,060	8,292	8,215
Total	$ 378,448	$ 377,130	$ 49,984	$ 50,204

	December 31, 2018			
	Available-for-Sale		Held-to-Maturity	
	Amortized Cost	Estimated Fair Value	Amortized Cost	Estimated Fair Value
Due within one year	$ 19,996	$ 19,739	$ 11,975	$ 11,911
Due after one but within five years	83,671	82,323	32,511	32,512
Due after five but within ten years	98,465	97,339	13,995	13,769
Due after ten years	184,155	181,641	9,607	9,285
Total	$ 386,287	$ 381,042	$ 68,088	$ 67,477

For the years ended December 31, 2019 and 2018, proceeds from sales of available-for-sale securities amounted to $50.1 million and $94.8 million, respectively; gross realized gains were $347 thousand, and gross realized losses were $0 and $593 thousand, respectively; gross unrealized gains were $226 thousand and $24 thousand, respectively, and gross unrealized losses were $1.5 million and $5.3 million, respectively.

Temporarily Impaired Securities

The following table indicates the gross unrealized losses and fair value of the Bank's investments, with unrealized losses that are not deemed to be OTTI, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position at December 31, 2019 and 2018.

	December 31, 2019					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ (8)	$ 15,008	$ (56)	$ 50,426	$ (64)	$ 65,434
U.S. government agency pool securities	(19)	15,619	(1,069)	144,607	(1,088)	160,226
U.S. government agency or GSE residential mortgage-backed securities	(200)	60,439	(192)	21,414	(392)	81,853
Total	$ (227)	$ 91,066	$ (1,317)	$ 216,447	$ (1,544)	$ 307,513
Securities Held to Maturity						
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ (1)	$ 2,010	$ -	$ -	$ (1)	$ 2,010
U.S. government agency pool securities	-	-	(70)	3,767	(70)	3,767
U.S. government agency or GSE residential mortgage-backed securities	(3)	3,483	(65)	5,014	(68)	8,497
Total	$ (4)	$ 5,493	$ (135)	$ 8,781	$ (139)	$ 14,274

	December 31, 2018					
	Less Than Twelve Months		More Than Twelve Months		Total	
	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value	Unrealized Losses	Estimated Fair Value
Securities Available for Sale						
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ -	$ -	$ (1,587)	$ 98,910	$ (1,587)	$ 98,910
U.S. government agency pool securities	(217)	32,633	(1,490)	157,403	(1,707)	190,036
U.S. government agency or GSE residential mortgage-backed securities	(116)	12,679	(1,859)	58,081	(1,975)	70,760
Total	$ (333)	$ 45,312	$ (4,936)	$ 314,394	$ (5,269)	$ 359,706
Securities Held to Maturity						
U.S. government agency and government sponsored enterprise (GSE) debt securities	$ (12)	$ 4,918	$ (76)	$ 8,954	$ (88)	$ 13,872
U.S. government agency pool securities	(62)	6,609	(18)	2,232	(80)	8,841
U.S. government agency or GSE residential mortgage-backed securities	(25)	5,219	(496)	12,330	(521)	17,549
Total	$ (99)	$ 16,746	$ (590)	$ 23,516	$ (689)	$ 40,262

The Bank does not believe that the investment securities that were in an unrealized loss position as of December 31, 2019, which comprised a total of 132 securities, were other than temporarily impaired. Specifically, the 132 securities are comprised of the following: 84 Small Business Administration (SBA) Pool securities, 15 mortgage-backed securities issued by Government National Mortgage Association (GNMA), 10 U.S. Treasuries, 15 mortgage-backed securities and 1 agency security issued by Federal National Mortgage Association (FNMA), 2 agency securities issued by Federal Home Loan Bank (FHLB) 4 mortgage-backed securities issued by Federal Home Loan Mortgage Corporation (FHLMC), and 1 agency security issued by Federal Farm Credit Banks (FFCB).

Total gross unrealized losses were 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 Bank does not intend to sell the investment securities that are in an unrealized loss position and it is not likely that, except as needed to fund our liquidity position, the Bank will be required to sell the investment securities before recovery of their amortized cost bases, which may be at maturity.

Investment in Unconsolidated Subsidiary

In May 2016, the Company entered into a Stock Purchase Agreement to acquire 25% of ASC Trust LLC. In July 2016, subsequent to the approval of the Federal Reserve Bank of San Francisco in June 2016, the purchase was executed. The Company took on $3.5 million in subordinated debt in connection with the purchase to finance the transaction, which debt has since been retired.

On July 1, 2019, with the approval of the Federal Reserve Bank of San Francisco, the Company used $4.1 million of the proceeds from the subordinated notes totaling $15.0 million that were issued on June 27, 2019, to acquire an additional 20% of the voting common stock of ASC Trust LLC at the second closing, pursuant to the Stock Purchase Agreement dated May 27, 2016, between the Company and David J. John, as amended to date. This transaction brought the Company's non-controlling interest in ASC Trust LLC to 45%. The Company's Chief Executive Officer serves on the Board of Directors of ASC Trust LLC. Another of the Company's Board members also serves as a non-majority voting member of an entity that owns 10% of the common stock of ASC Trust LLC. See "Note 22 – Subordinated Debt" for more detailed information on the subordinated notes. The Agreement provides for the acquisition of an additional 25% of the stock of ASC Trust LLC in April 2021, with the future purchase subject to regulatory approval. The Agreement contains customary warranties, representations and indemnification provisions.

Note 6 – Loans

The Bank provides commercial and industrial, commercial mortgage, commercial construction, automobile and other consumer loans in each of the markets it serves. It also offers residential mortgage, home equity and certain U.S. government guaranteed loans in Guam, the Northern Mariana Islands and California. The Bank has two commercial agricultural loans outstanding in Guam.

Outstanding loan balances are presented net of unearned income, net deferred loan fees, and unamortized discount and premium totaling $2.9 million at December 31, 2019 and $2.6 million at December 31, 2018.

The loan portfolio consisted of the following at:

	December 31,			
	2019		2018	
	Amount	Percent	Amount	Percent
Commercial				
Commercial & industrial	$ 282,426	21.6%	$ 243,465	19.6%
Commercial mortgage	591,364	45.3%	560,827	45.3%
Commercial construction	71,101	5.4%	39,408	3.2%
Commercial agriculture	664	0.1%	688	0.1%
Total commercial	945,555	72.4%	844,388	68.2%
Consumer				
Residential mortgage	124,250	9.5%	138,923	11.2%
Home equity	2,685	0.2%	1,325	0.1%
Automobile	21,631	1.7%	26,686	2.2%
Other consumer loans[1]	211,884	16.2%	227,242	18.3%
Total consumer	360,450	27.6%	394,176	31.8%
Gross loans	1,306,005	100.0%	1,238,564	100.0%
Deferred loan (fees) costs, net	(2,863)		(2,649)	
Allowance for loan losses	(27,870)		(23,774)	
Loans, net	$ 1,275,272		$ 1,212,141	

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

At December 31, 2019, total gross loans increased by $67.4 million, to $1.31 billion, up from $1.24 billion at December 31, 2018 . The growth in loans was largely attributed to (i) an increase of $39.0 million in the commercial & industrial loan category, from $243.5 million to $282.4 million, (ii) an increase of $31.7 million in commercial construction loans, from $39.4 million to $71.1 million, (iii) a $30.5 million increase in commercial mortgage loans, to $591.4 million from $560.8 million, due to new loans, and (iv) an increase of $1.4 million in home equity loans, from $1.3 million to $2.7 million. These were partially offset by (i) a $15.4 million decrease in other consumer loans, to $211.9 million from $227.2 million, due primarily to payoffs and paydowns, (ii) a $14.7 million decrease in residential mortgage loan category due to payoffs and paydowns, and (iii) a $5.1 million decrease in automobile loans outstanding.

Allowance for Loan Losses

The allowance for loan losses is evaluated on a regular basis by 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.

The portion of the allowance that covers unimpaired loans is based on historical charge-off experience and expected loss, given the default probability derived from the Bank’s internal risk rating process. Other adjustments may be made to the allowance for pools of loans after an assessment of internal or external influences on credit quality that are not fully reflected in the historical loss or risk rating data.

Our 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” (“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 portfolios.

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.” Loans to strong borrowers with a demonstrated history of financial and managerial performance. Risk of loss is considered to be low. Loans are well structured, with clearly identified primary and readily available secondary sources of repayment. Loans may be secured by an equal amount of funds in a savings account or time certificate of deposit. Loans may be secured by marketable collateral whose value can be reasonably determined through outside appraisals. Very strong cash flow and relatively low leverage.

Pass (C): *Acceptable:* “Good” primary and secondary sources of repayment. Loans to borrowers of average financial strength, stability and management expertise. Borrower should be a well-established individual or company with adequate financial resources to weather short-term fluctuations in the marketplace. 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, reasonable credit risk and requiring an average amount of account officer attention. Unsecured credit is to be of unquestionable strength.

Pass (D): *Monitor:* “Sufficient” primary source of repayment and acceptable secondary source of repayment. Acceptable business or individual credit, but the borrower’s operations, cash flow or financial conditions evidence moderate to average levels of risk. 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 failure.

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. Special Mention 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 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 residential real estate and consumer loans and credit cards. Commercial loans are typically formally classified by the Loan Committee no later than their 90-day delinquency, and thus usually do not become part of the formula classification. Real estate loans 90 days delinquent are in the foreclosure process and are 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, which 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 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.

Set forth below is information regarding gross loan balances and the related allowance for loan losses, by portfolio type, for the years ended December 31, 2019 and 2018.

	Commercial	Residential Mortgages	Consumer	Total
		(Dollars in thousands)		
Year Ended December 31, 2019				
Allowance for loan losses:				
Balance at beginning of period	$ 14,887	$ 1,648	$ 7,239	$ 23,774
Charge-offs	(1,599)	-	(6,306)	(7,905)
Recoveries	37	67	2,109	2,213
Provision	5,035	(225)	4,978	9,788
Balance at end of period	$ 18,360	$ 1,490	$ 8,020	$ 27,870
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	$ 6,105	$ 2	$ 1,657	$ 7,764
Loans collectively evaluated for impairment	12,255	1,488	6,363	20,106
Ending balance	$ 18,360	$ 1,490	$ 8,020	$ 27,870
Loan balances at end of period:				
Loans individually evaluated for impairment	$ 34,185	$ 3,758	$ 1,808	$ 39,751
Loans collectively evaluated for impairment	911,370	123,177	231,707	1,266,254
Ending balance	$ 945,555	$ 126,935	$ 233,515	$ 1,306,005
Year Ended December 31, 2018				
Allowance for loan losses:				
Balance at beginning of period	$ 7,623	$ 1,409	$ 8,247	$ 17,279
Charge-offs	(356)	(9)	(7,836)	(8,201)
Recoveries	39	7	1,788	1,834
Provision	7,581	241	5,040	12,862
Ending balance	$ 14,887	$ 1,648	$ 7,239	$ 23,774
Allowance balance at end of period related to:				
Loans individually evaluated for impairment	$ 5,204	$ 104	$ 1,518	$ 6,826
Loans collectively evaluated for impairment	9,683	1,544	5,721	16,948
Ending balance	$ 14,887	$ 1,648	$ 7,239	$ 23,774
Loan balances at end of period:				
Loans individually evaluated for impairment	$ 18,328	$ 4,925	$ 1,746	$ 24,999
Loans collectively evaluated for impairment	826,060	135,323	252,182	1,213,565
Ending balance	$ 844,388	$ 140,248	$ 253,928	$ 1,238,564

The $4.1 million increase in the allowance for loan losses is primarily due to the high balance in classified loans, consumer loan delinquency rates and the result of the bankruptcy filing of two commercial loan borrowers in 2019, along with management's reassessment of economic conditions and prospects. The allowance will change in the future in response to changes in the size, composition and quality of the loan portfolio, as well as periodic reassessments of prospective economic conditions. The two borrowers that filed for bankruptcy were evaluated under ASC 450 – *"Contingencies"*, and the Bank has assigned a specific allowance of $5.2 million for one borrower and $933 thousand for the other borrower. The outstanding loans under bankruptcy have been classified as doubtful in 2019.

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 and are not immediately written-off, but a portion of the allowance is allocated to these loans based on the evaluation. 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 reserve to zero at the end of each reporting period.

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

	30-59 Days Past Due	60-89 Days Past Due	90 Days and Greater Non-Accrual	90 Days and Greater Still Accruing	Total Past Due	Current	Total Loans Outstanding
December 31, 2019							
Commercial							
Commercial & industrial	$ 15,924	$ -	$ 4,076	$ -	$ 20,000	$ 262,426	$ 282,426
Commercial mortgage	1,490	358	2,698	-	4,546	586,818	591,364
Commercial construction	-	-	-	-	-	71,101	71,101
Commercial agriculture	-	-	-	-	-	664	664
Total commercial	17,414	358	6,774	-	24,546	921,009	945,555
Consumer							
Residential mortgage	5,318	3,515	1,214	187	10,234	114,016	124,250
Home equity	-	-	-	-	-	2,685	2,685
Automobile	1,241	278	-	93	1,612	20,019	21,631
Other consumer [1]	2,991	1,515	96	1,510	6,112	205,772	211,884
Total consumer	9,550	5,308	1,310	1,790	17,958	342,492	360,450
Total	$ 26,964	$ 5,666	$ 8,084	$ 1,790	$ 42,504	$1,263,501	$ 1,306,005
December 31, 2018							
Commercial							
Commercial & industrial	$ 310	$ -	$ 14	$ 530	$ 854	$ 242,611	$ 243,465
Commercial mortgage	419	-	1,287	184	1,890	558,937	560,827
Commercial construction	300	-	-	-	300	39,108	39,408
Commercial agriculture	-	-	-	-	-	688	688
Total commercial	1,029	-	1,301	714	3,044	841,344	844,388
Consumer							
Residential mortgage	4,565	3,847	1,805	12	10,229	128,694	138,923
Home equity	-	91	-	-	91	1,234	1,325
Automobile	1,095	290	-	135	1,520	25,166	26,686
Other consumer [1]	3,505	1,583	335	1,123	6,546	220,696	227,242
Total consumer	9,165	5,811	2,140	1,270	18,386	375,790	394,176
Total	$ 10,194	$ 5,811	$ 3,441	$ 1,984	$ 21,430	$1,217,134	$ 1,238,564

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

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 it 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 December 31, 2019 and 2018, with respect to loans on non-accrual status, by portfolio type:

	December 31,	
	2019	2018
	(Dollars in thousands)	
Non-accrual loans:		
Commercial		
Commercial & industrial	$ 10,587	$ 310
Commercial mortgage	8,100	6,909
Commercial construction	-	-
Commercial agriculture	-	-
Total commercial	18,687	7,219
Consumer		
Residential mortgage	$ 3,370	$ 4,795
Home equity	-	91
Automobile	-	-
Other consumer [1]	206	278
Total consumer	3,576	5,164
Total non-accrual loans	$ 22,263	$ 12,383

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

The Company 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 Company's internal credit quality ratings as of December 31, 2019 and 2018.

	December 31, 2019	December 31, 2018	Increase (Decrease)
	(Dollars in thousands)		
Pass:			
Commercial & industrial	$ 247,202	$ 204,805	$ 42,397
Commercial mortgage	551,459	515,764	35,695
Commercial construction	71,101	39,408	31,693
Commercial agriculture	664	688	(24)
Residential mortgage	119,851	133,766	(13,915)
Home equity	2,685	1,235	1,450
Automobile	21,538	26,550	(5,012)
Other consumer	210,165	225,632	(15,467)
Total pass loans	$ 1,224,665	$ 1,147,848	$ 76,817
Special Mention:			
Commercial & industrial	$ 3,641	$ 8,732	$ (5,091)
Commercial mortgage	-	8,990	(8,990)
Total special mention loans	$ 3,641	$ 17,722	$ (14,081)
Substandard:			
Commercial & industrial	$ 21,597	$ 29,924	$ (8,327)
Commercial mortgage	38,414	36,073	2,341
Residential mortgage	762	705	57
Other consumer	12	-	12
Total substandard loans	$ 60,785	$ 66,702	$ (5,917)
Formula Classified:			
Commercial & industrial	$ -	$ 4	$ (4)
Residential mortgage	3,637	4,452	(815)
Home equity	-	91	(91)
Automobile	93	135	(42)
Other consumer	1,707	1,610	97
Total formula classified loans	$ 5,437	$ 6,292	$ (855)
Doubtful:			
Commercial & industrial	$ 9,986	$ -	$ 9,986
Commercial mortgage	1,491	-	1,491
Total doubtful loans	$ 11,477	$ -	$ 11,477
Total outstanding loans, gross	$ 1,306,005	$ 1,238,564	$ 67,441

As the above table indicates, the Company's total loans approximated $1.31 billion at December 31, 2019, up from $1.24 billion at December 31, 2018. The disaggregation of the portfolio by risk rating in the table reflects the following changes between December 31, 2018, and December 31, 2019:

- Loans rated "pass" totaled $1.22 billion at December 31, 2019, an increase of $76.8 million from $1.15 billion at December 31, 2018, due primarily to the increases of $42.4 million in commercial and industrial, $35.7 million in commercial mortgage, $31.7 million in commercial construction loans and $1.5 million in home equity loans. The increase in commercial & industrial, commercial mortgage and home equity were due to new loans. Additionally, commercial & industrial had three loans reclassified from "special mention" to "pass" totaling $265 thousand and commercial mortgage had two loans reclassified from "special mention" to "pass" totaling $4.3 million. The increase in commercial mortgage was partially offset by the reclassification of two loans totaling $1.2 million from "pass" to "substandard". The increase in commercial construction was due to additional disbursement and new loans. These increases were offset by the decreases of $15.5 million in other consumer loans, $13.9 million in residential mortgage loans and $5.0 million in automobile loans. The decreases in other consumer and automobile loans were due to payoffs, pay downs and charge-offs, partially offset by the addition of new consumer loan and automobile loan bookings.

- The “special mention” category decreased by $14.1 million to $3.6 million at December 31, 2019. The commercial mortgage loan category decreased by $9.0 million, due to the three loan relationships totaling $4.3 million being reassigned from “special mention” to “pass.” In addition, there was a loan payoff of $4.4 million. The commercial & industrial loan category decreased by $5.1 million, due primarily to one loan relationships totaling $4.3 million moved from “special mention” to “substandard.” In addition three loans classified from “special mention” to “pass” totaling $265 thousand.
- Loans classified as “substandard” decreased by $5.9 million, to $60.8 million at December 31, 2019. Substandard commercial and industrial loans decreased by $8.3 million, to $21.6 million, due primarily to the downgrade of one loan relationship to ‘doubtful” totaling $9.2 million. The commercial mortgage loans increased by $2.3 million, to $38.4 million, primarily due to additional disbursements from one loan relationship totaling $2.5 million. In addition two loans relationship were downgraded from “pass” to “substandard” totaling $1.2 million.
- The “formula classified” category decreased by $855 thousand during the period, to $5.4 million, primarily because of the decrease of $815 thousand in residential mortgages in this classification, due to regular loan pay downs and payoffs. Additional decreases of $91 thousand in the home equity category, and $42 thousand in the automobile category were offset by an increase of $97 thousand in other consumer loans.
- The “doubtful” category increased by $11.5 million due to the two commercial borrowers that filed for bankruptcy. The increase is due to the $10.0 million rise in the commercial & industrial loans category, and the $1.5 million increase in commercial 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 Company’s loss mitigation actions, and could include reductions in the interest rate, payment extensions, forgiveness of principal, 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 December 31, 2019 and 2018:

	December 31, 2019	December 31, 2018
	(Dollars in thousands)	
Impaired loans:		
Restructured loans:		
Non-accruing restructured loans	$ 7,293	$ 5,653
Accruing restructured loans	15,191	254
Total restructured loans	22,484	5,907
Other impaired loans	17,267	19,092
Total impaired loans	$ 39,751	$ 24,999
Impaired loans less than 90 days delinquent and included in total impaired loans	$ 29,704	$ 19,287

The table below contains additional information with respect to impaired loans, by portfolio type, for the years ended December 31, 2019 and 2018:

	Recorded Investment	Unpaid Principal Balance	Average Recorded Investment	Interest Income Recognized
	(Dollars in thousands)			
December 31, 2019, With no related allowance recorded:				
Commercial & industrial	$ 25,702	$ 26,627	$ 20,734	$ 105
Commercial mortgage	8,138	8,138	9,230	(1)
Commercial construction	-	-	-	-
Commercial agriculture	-	-	-	-
Residential mortgage	379	379	115	(174)
Home equity	-	-	-	-
Automobile	-	-	-	-
Other consumer	-	-	-	-
Total impaired loans with no related allowance	$ 34,219	$ 35,144	$ 30,079	$ (70)
December 31, 2019, With a related allowance recorded:				
Commercial & industrial	$ 247	$ 472	$ 214	$ 1
Commercial mortgage	98	114	79	-
Commercial construction	-	-	-	-
Commercial agriculture	-	-	-	-
Residential mortgage	3,379	3,400	4,260	(6)
Home equity	-	-	-	-
Automobile	93	93	97	2
Other consumer	1,715	1,716	1,516	18
Total impaired loans with a related allowance	$ 5,532	$ 5,795	$ 6,166	$ 15
December 31, 2018, With no related allowance recorded:				
Commercial & industrial	$ 11,110	$ 11,110	$ 3,206	$ 51
Commercial mortgage	7,016	7,026	6,759	4
Commercial construction	-	-	-	-
Commercial agriculture	-	-	-	-
Residential mortgage	27	27	27	-
Home equity	-	-	-	-
Automobile	-	-	-	-
Other consumer	-	-	-	-
Total impaired loans with no related allowance	$ 18,153	$ 18,163	$ 9,992	$ 55
December 31, 2018, With a related allowance recorded:				
Commercial & industrial	$ 126	$ 300	$ 181	$ -
Commercial mortgage	77	93	272	1
Commercial construction	-	-	-	-
Commercial agriculture	-	-	-	-
Residential mortgage	4,807	4,857	4,933	2
Home equity	91	91	24	-
Automobile	135	135	97	2
Other consumer	1,610	1,401	1,903	19
Total impaired loans with a related allowance	$ 6,846	$ 6,877	$ 7,410	$ 24

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, thereby reducing the allocated component of the reserve to zero at the end of each reporting period.

Troubled Debt Restructurings

The Bank had $22.5 million and $5.9 million of troubled debt restructurings (TDRs) as of December 31, 2019 and 2018, respectively. The restructured loans recorded by the Bank represent financing receivables, 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, a reduction in the interest rate, interest only payments and, in limited cases, a concession to the outstanding loan balance. The workout plans between the borrower and Bank are designed to provide a bridge for the 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.

	Number of Loans	Pre-Modification Outstanding Recorded Investment	Principal Modifications	Post-Modification Outstanding Recorded Investment	Outstanding Balance December 31, 2019	Outstanding Balance December 31, 2018
Performing						
Residential mortgage	1	$ 27	$ -	$ 27	$ 26	$ 27
Commercial mortgage	5	16,074	-	16,074	15,165	226
Automobile	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total performing	6	$ 16,101	$ -	$ 16,101	$ 15,191	$ 253
Nonperforming						
Residential mortgage	-	$ -	$ -	$ -	$ -	$ -
Commercial mortgage	16	11,287	-	11,287	7,293	5,654
Automobile	-	-	-	-	-	-
Consumer	-	-	-	-	-	-
Total nonperforming	16	$ 11,287	$ -	$ 11,287	$ 7,293	$ 5,654
Total Troubled Debt Restructurings (TDRs)	22	$ 27,388	$ -	$ 27,388	$ 22,484	$ 5,907

Note 7 – Premises and Equipment

A summary of premises and equipment at December 31, 2019 and 2018 follows:

	December 31, 2019 Cost	December 31, 2019 Accumulated Depreciation	December 31, 2019 Net Book Value
Buildings	$ 28,927	$ (21,182)	$ 7,745
Furniture and equipment	26,494	(19,312)	7,182
Automobiles and mobile facilities	1,698	(1,003)	695
Leasehold improvements	6,662	(4,255)	2,407
	63,781	(45,752)	18,029
Construction in progress	1,725	-	1,725
	$ 65,506	$ (45,752)	$ 19,754

	December 31, 2018 Cost	December 31, 2018 Accumulated Depreciation	December 31, 2018 Net Book Value
Buildings	$ 28,268	$ (20,461)	$ 7,807
Furniture and equipment	24,516	(18,424)	6,092
Automobiles and mobile facilities	1,588	(948)	640
Leasehold improvements	5,687	(3,929)	1,758
	60,059	(43,762)	16,297
Construction in progress	2,174	-	2,174
	$ 62,233	$ (43,762)	$ 18,471

For the years ended December 31, 2019, 2018 and 2016, depreciation expense was $3.9 million and $3.6 million, respectively.

Note 8 – Other Assets

A summary of other assets at December 31, 2019 and 2018, follows:

	December 31,	
	2019	2018
Bank Owned Life Insurance	$ 20,700	$ 19,881
Prepaid income tax	-	1
Prepaid expenses	6,100	7,081
Other real estate owned, net (Note 9)	6	1,510
Deferred tax asset, net (Note 13)	7,546	6,942
Mortgage servicing rights (Note 19)	1,704	1,778
Goodwill	783	783
Right-of-use asset (Note 20)	29,898	-
Accounts receivable	16,015	4,854
Other	763	1,767
Total other assets	$ 83,515	$ 44,597

Note 9 – Other Real Estate Owned

Other real estate owned is presented net of an allowance for losses. A summary of the changes in other real estate owned is as follows:

	2019	2018
Balance at beginning of year	$ 1,510	$ 2,369
Additions	-	-
Sales	(352)	(238)
	1,158	2,131
Write-downs and loss on sales, net	(1,183)	(685)
Change in valuation allowances	31	64
Balance at end of year	$ 6	$ 1,510

Note 10 – Deposits

A summary of deposits at December 31, 2019 and 2018, follows:

	December 31,	
	2019	2018
	(Dollars in Thousands)	
Non-interest bearing deposits	$ 582,967	$ 538,168
Interest bearing deposits:		
Demand deposits	278,914	281,582
Regular savings	627,596	670,640
Time deposits:		
$250,000 or more	14,201	14,201
Less than $250,000	17,797	21,986
Other interest bearing deposits	208,431	202,246
Total interest bearing deposits	1,146,939	1,190,655
Total Deposits	$ 1,729,906	$ 1,728,823

At December 31, 2019, the scheduled maturities of time deposits were as follows:

Years ending December 31,		
2020	$	26,853
2021		1,957
2022		803
2023		261
2024 and thereafter		2,124
Total	$	31,998

Note 11 – Borrowings

Federal Reserve Discount Window

At December 31, 2019 and 2018 the Bank had investment securities with a market value of $20.9 million and $22.5 million, respectively, pledged to the FRB Discount Window supporting a borrowing capacity of $20.3 million and $21.8 million, respectively, based on the Federal Reserve margin of 97%. The Bank had no outstanding borrowings through the discount window at December 31, 2019 or 2018.

Federal Home Loan Bank (FHLB) Advances

The Bank has a credit line with the FHLB of Des Moines equal to 35% of total Bank assets. At December 31, 2019 and 2018, the Bank did not have outstanding advances against this credit line under Blanket Agreements for Advances and Security Agreements ("the Agreements"). The Agreements enable the Bank to borrow funds from the FHLB to fund mortgage loan programs and to satisfy certain other funding needs.

Overnight Fed Funds Lines

At December 31, 2019 and 2018, the Bank had $17.0 million in Federal Funds lines of credit available with its correspondent banks. No borrowings were outstanding as of December 31, 2019.

Note 12 – Transactions with Directors of the Company

The Directors of the Company and the Bank, and certain of the businesses with which they are associated, conduct banking transactions with the Company in the ordinary course of business. The following is a summary of loan transactions with members of the Board of Directors of the Company and certain of their associated businesses:

	Years Ended December 31,			
	2019		**2018**	
	(Dollars in thousands)			
Beginning balance	$	9,823	$	9,466
Undisbursed commitments		1,562		400
New loans granted		2,378		655
Principal repayments		(1,226)		(698)
Ending balance of term loans		12,537		9,823
Year-end balance of revolving accounts		1,007		1,994
Total term loans and revolving accounts	$	13,544	$	11,817

In addition, 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 years ended December 31, 2019 and 2018, approximated $354 thousand and $350 thousand, respectively.

Note 13 – Income Taxes

The Bank pays income taxes in Guam and the Commonwealth of the Northern Mariana Islands under a territorial "mirror" of the U.S. Internal Revenue Code, with payments made to the respective territorial governments instead of the U.S. Treasury; there is no equivalent of a state income tax in either of these jurisdictions. The Bank also pays taxes to the governments of the Republic of Palau, the Federated States of Micronesia, the Republic of the Marshall Islands and the State of California.

The income tax provision includes the following components:

	Years Ended December 31, 2019	2018
Government of Guam tax expense (benefit):		
Current	$ 5,897	$ 3,200
Deferred	(931)	(1,675)
Foreign income taxes (including U.S. income taxes)	635	1,388
Total income tax expense	$ 5,601	$ 2,913

The reasons for the differences between the statutory federal income tax rate and the effective tax rates are summarized as follows:

	2019	2018
Statutory Guam income tax rate	21.00%	21.00%
Permanent differences	-1.03%	-3.02%
Other	5.78%	0.52%
Total income tax expense	25.75%	18.50%

The difference between effective income tax expense and 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, 2019 and 2018. Additionally, there was a one-time impact on total income tax expense and the effective tax rate in 2019 due to a $921 thousand adjustment.

The components of deferred income taxes are as follows:

	Years Ended December 31, 2019	2018
Deferred loan origination fees	$ (48)	$ 28
Mortgage servicing rights	(16)	(27)
Loan loss provision	(906)	(1,430)
Deferred rent	224	(10)
Other real estate owned valuation	7	14
Fixed assets	15	15
SERP	(207)	(246)
Accrued bonus	58	(19)
Right-of-use asset	6,615	-
Lease liability	(6,673)	-
Net operating loss	(1,815)	(2,188)
Change in valuation allowance	1,815	2,188
Deferred tax (benefit) provision	$ (931)	$ (1,675)

The components of the net deferred tax asset are as follows:

	Years Ended December 31, 2019	2018
Deferred tax asset:		
Allowance for loan losses	$ 6,076	$ 5,170
Net operating loss	1,815	2,188
Loan origination fees	621	573
Stock-based compensation	-	1,335
Net unrealized gain on securities available-for-sale	277	606
Deferred rent	58	224
Accruals not currently deductible	1,541	64
Total deferred tax asset	10,388	10,160
Deferred tax liability:		
Fixed assets	(659)	(645)
Mortgage servicing rights	(368)	(385)
Total deferred tax liability	(1,027)	(1,030)
Valuation allowance	(1,815)	(2,188)
Net deferred tax asset	$ 7,546	$ 6,942

A valuation allowance of $1.8 million and $2.2 million have been provided at December 31, 2019 and 2018, respectively, to reduce the deferred tax asset because, in management's opinion, it is more likely than not that less than the entire amount will be realized. This is primarily due to the operating losses in the CNMI region.

We record as a "deferred tax asset" on our balance sheet an amount equal to the tax credit and 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. Under applicable federal and state income tax laws and regulations, 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 (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.

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 before 2012.

Note 14 – Employee Benefit Plans

Stock Purchase Plan

The Company's 2011 Employee Stock Purchase Plan (the "2011 Plan") was adopted by the Company's Board of Directors and approved by the Company's Stockholders on May 2, 2011. The 2011 Plan is open to all employees of the Company and the Bank who have met certain eligibility requirements.

Under the 2011 Plan, as amended and restated as of July 1, 2012, 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. The Company recognized $34 thousand and $11 thousand in compensation expense in 2019 and 2018, respectively.

Employee Retirement Savings Plan

The Company has a 401(k) Plan whereby substantially all employees, with at least one year of continuous service, are eligible to participate in the Plan. The Company makes matching contributions equal to 100% of an employee's deferrals, up to 1% of the employee's compensation, plus 50% of the employee's deferrals that exceed 1% but are less than 6% of the employee's compensation. Matching contributions become 100% vested to the employee after two years of service. For the years ended December 31, 2019 and 2018, the expense attributable to the Plan was $725 thousand and $721 thousand, respectively.

Supplemental Executive Retirement Plan ("SERP")

In April 2011, the Bank established an unfunded Supplemental Executive Retirement Plan (the "SERP") for its Executive Officers and Senior Vice Presidents. The SERP provides that, subject to meeting certain vesting requirements, they will become entitled to receive 12 equal successive monthly retirement payments totaling $50,000 per annum for Senior Vice Presidents, $100,000 for the Executive Vice Presidents, and $150,000 for the President and CEO for the 15 years immediately following the date of their retirement or other termination of their employment.

The Company follows FASB ASC 715-30-35, which requires us to recognize in our balance sheet the funded status of any post-retirement plans that we maintain, and to recognize, in other comprehensive income, changes in the funded status of any such plans in any year in which changes occur.

The changes in the projected benefit obligation of other benefits under the Plan during 2019 and 2018, its funded status at December 31, 2019 and 2018, and the amounts recognized in the balance sheet at December 31, 2019 and 2018, were as follows:

	Years Ended December 31,	
	2019	2018
Change in benefit obligation:		
Benefit obligation at beginning of period	$ 6,074	$ 4,958
Service cost	672	901
Interest cost	263	215
Benefit obligation at end of period	$ 7,009	$ 6,074
Funded status:		
Amounts recognized in the Statement of Financial Condition		
Unfunded accrued SERP liability—current	$ 7,009	$ 6,074
Total unfunded accrued SERP liability	$ 7,009	$ 6,074
Net amount recognized in accumulated other comprehensive income		
Prior service cost/(benefit)	$ -	$ -
Net actuarial loss/(gain)	-	-
Total net amount recognized in accumulated other comprehensive income	-	-
Accumulated benefit obligation	$ 7,009	$ 6,074
Components of net periodic SERP cost:		
Service cost	$ 6,027	$ 5,355
Interest cost	982	719
Net periodic SERP cost	$ 7,009	$ 6,074
Assumptions as of December 31:		
Assumed discount rate	4.33%	4.33%
Rate of compensation increase	0.00%	0.00%

As of December 31, 2019, $2.4 million in benefits are expected to be paid in the next five years. During 2020, $1.2 million is expected to be recognized in net periodic benefit cost.

Note 15 – 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 solely to shares for which employees' funds have been collected but not issued under the Employee Stock Purchase Plan for 2019 and 2018, and are determined using the treasury stock method.

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

	Years Ended December 31,	
	2019	2018
Net income	$ 16,151	$ 12,839
Less preferred stock dividends	(547)	(546)
Net income attributable to common stockholders	$ 15,604	$ 12,293
Weighted average number of common shares outstanding - used to calculate basic anddiluted earnings per common share	9,657	9,614
Earnings per common share:		
Basic	$ 1.62	$ 1.28
Diluted	$ 1.62	$ 1.28

Note 16 – Commitments and Contingencies

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 the same credit policies in making commitments and conditional obligations as it does for on-balance sheet instruments.

A summary of financial instruments with off-balance-sheet risk at December 31, 2019 and 2018, is as follows:

	December 31,	
	2019	2018
Commitments to extend credit	$ 157,463	$ 163,802
Letters of credit:		
Standby letters of credit	$ 58,182	$ 55,418
Commercial letters of credit	513	3,070
Total	$ 58,695	$ 58,488

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 the 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 credit worthiness 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. The Bank had recorded $36.0 thousand in reserve liabilities associated with these commitments at December 31, 2019.

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 government and private borrowing arrangements. Essentially 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. The Bank generally holds collateral supporting these commitments.

The Bank considers its standby letters of credit to be guarantees. At December 31, 2019, the maximum undiscounted future payments that the Bank could be required to make was $58.7 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, some are unsecured. The Bank recorded $36.0 thousand in reserve liabilities associated with these guarantees at December 31, 2019.

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 $189.5 million and $189.6 million at December 31, 2019 and 2018, respectively. At December 31, 2019 and 2018, the Bank recorded mortgage servicing rights at their fair value of $1.7 million and $1.8 million, respectively.

Legal Contingencies

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 are expected to have a material adverse effect on the Bank's financial position, results of operations or cash flows.

Note 17 – 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 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, Tier 1 capital and common equity 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). As of December 31, 2019 and 2018, the Bank met all capital adequacy requirements to which it is subject.

In December 2010, the Basel Committee on Bank Supervision ("Basel Committee") released its final framework for strengthening international capital and liquidity regulation, now officially identified as "Basel III," which, when fully phased-in, would require bank holding companies and their bank subsidiaries to maintain substantially more capital than had previously been required, with a greater emphasis on common equity.

In July 2013, the U.S. banking regulatory agencies approved the U.S. version of Basel III. The agencies-adopted version of Basel III revises the risk-based and leverage capital requirements and the method for calculating risk-weighted assets to make them consistent with Basel III and to meet the requirements of the Dodd-Frank Act. Although many of the rules contained in these final regulations are applicable only to large, internationally active banks, some of them apply on a phased-in basis to all banking organizations, including the Company and the Bank. The rules, including alternative requirements for smaller community financial institutions like the Company and the Bank, were fully phased in on January 1, 2019. Among other things, the rules established a new minimum common equity Tier 1 ratio (4.5% of risk-weighted assets), a higher minimum Tier 1 risk-based capital requirement (6.0% of risk-weighted assets) and a minimum non-risk-based leverage ratio (4.0%, eliminating a 3.0% exception for higher rated banks). The new additional capital conservation buffer of 2.5% of risk weighted assets over each of the required capital ratios was phased in from 2016 to 2019 (2.500% in 2019 and 1.875% in 2018) and must be met to avoid limitations on the ability of the Company and the Bank to pay dividends, repurchase shares or pay discretionary bonuses. An additional "countercyclical capital buffer" is required for larger and more complex institutions. The new rules assign higher risk weighting to exposures that are more than 90 days past due or are on nonaccrual status and certain commercial real estate facilities that finance the acquisition, development or construction of real property. The rules also changed the permitted composition of Tier 1 capital to exclude trust preferred securities, mortgage servicing rights and certain deferred tax assets, and include unrealized gains and losses on available-for-sale debt and equity securities (through a one-time opt out option for Standardized Banks (banks with less than $250 billion of total consolidated assets and less than $10 billion of foreign exposures) which the Company and the Bank elected at March 31, 2015).

As of December 31, 2019, 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, common equity 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 Company's actual capital amounts and ratios as of December 31, 2019 and 2018, are presented in the table below.

	Actual		For Capital Adequacy Purposes		To Be Well Capitalized Under Prompt Corrective Action Provisions	
	Amount	**Ratio**	**Amount**	**Ratio**	**Amount**	**Ratio**
At December 31, 2019:						
Total capital (to Risk Weighted Assets)	$ 197,000	14.417%	$ 109,313	8.000%	$ 136,641	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 164,787	12.060%	$ 81,985	6.000%	$ 109,313	8.000%
Tier 1 capital (to Average Assets)	$ 164,787	8.418%	$ 78,298	4.000%	$ 97,873	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 155,005	11.344%	$ 61,489	4.500%	$ 88,817	6.500%
At December 31, 2018:						
Total capital (to Risk Weighted Assets)	$ 167,732	13.662%	$ 98,219	8.000%	$ 122,774	10.000%
Tier 1 capital (to Risk Weighted Assets)	$ 152,281	12.403%	$ 73,664	6.000%	$ 98,219	8.000%
Tier 1 capital (to Average Assets)	$ 152,281	7.991%	$ 76,229	4.000%	$ 95,287	5.000%
Common Equity Tier 1 Capital (to Risk Weighted Assets)	$ 142,498	11.607%	$ 55,248	4.500%	$ 79,803	6.500%

The Bank exceeds the adequately capitalized and the well capitalized standards under these measures. Management believes the Company and the Bank will remain adequately capitalized and well-capitalized under the standards.

Since the formation of the Company in 2011, our assets have grown by 77.0% ($849.8 million), while our stockholders' equity has grown by 85.1% ($75.5 million, including $57.6 million in retained earnings). The growth in equity has helped to increase our capital ratios, and those ratios remain well above the well capitalized standards. To provide sufficient capital resources to expand our holdings, the Board approved the issuance of an additional $5.0 million in common stock during 2015, of which $2.9 million in was issued that year, and an additional $10.0 million in non-cumulative perpetual preferred stock, of which $9.8 million was issued during 2016. During the fourth quarter of 2017 and the first quarter of 2018, the Company issued an additional $4.2 million in common stuck in an SEC-registered public offering at a purchase price of $12.25 per common share.

Non-Cumulative Perpetual Preferred Stock

Commencing September 15, 2016, the Company offered a private placement of securities for the issuance and sale of an aggregate of 10,000 shares of its new Series A Non-Cumulative Perpetual Preferred Stock. This offer carried a subscription price of $1,000.00 per share and a yield of 5.5% (the "Series A Preferred Stock") to various accredited and a limited number of non-accredited investors for total proceeds of up to $10 million (the "Offering"). Each subscriber could purchase a minimum number of Series A Preferred Stock equivalent to at least $250,000 (250 shares). The Offering agreement contains customary warranties, representations and indemnification provisions, and expired on December 31, 2016. At December 31, 2018, 9,800 of these shares were issued and outstanding.

Note 18 – Parent Company Only Information

Condensed Statements of Financial Condition
(Dollars in thousands)

	December 31,			
	2019		2018	
Assets				
Due from subsidiaries	$	1,918	$	1,158
Investment in subsidiaries		177,182		147,147
Other assets		13		-
Total assets	$	179,113	$	148,305
Liabilities and stockholders’ equity				
Other liabilities		119		10
Subordinated debt, net		14,751		-
Total liabilities	$	14,870	$	10
Stockholders’ equity		164,243		148,295
Total liabilities and stockholders’ equity	$	179,113	$	148,305

Condensed Statements of Income
(Dollars in thousands)

	December 31,			
	2019		2018	
Dividend income	$	4,142	$	4,134
Interest expense		484		-
Other expenses		364		362
Equity in undistributed income of subsidiary		12,857		9,067
Net income	$	16,151	$	12,839

Condensed Statements of Cash Flows
(Dollars in thousands)

	December 31,	
	2019	**2018**
Cash flows from operating activities:		
Net income	$ 16,151	$ 12,839
Adjustments to reconcile net income to net cash provided by operating activities:		
Undistributed earnings of subsidiary	(12,857)	(9,067)
Amortization of debt issuance costs		
Net change in operating assets and liabilities:		
Other assets	(13)	14
Other liabilities	110	-
Net cash provided by operating activities	3,142	3,786
Cash flows from investing activities:		
Payments for investments in and advances to subsidiaries	(10,000)	(2,640)
Increased investment in unconsolidated subsidiary	(4,090)	-
Dividends received from consolidated subsidiary	227	-
Dividends received from unconsolidated subsidiary	621	402
Net cash used in investing activities	(13,242)	(2,238)
Cash flows from financing activities:		
Proceeds from issuance of subordinated debt	15,000	-
Cash dividends paid	(4,410)	(4,401)
Proceeds from issuance of common stock	270	2,763
Net cash (used in) provided by financing activities	10,860	(1,638)
Net change in cash and cash equivalents	760	(90)
Cash and cash equivalents, beginning of period	1,158	1,248
Cash and cash equivalents, end of period	$ 1,918	$ 1,158

Note 19 – Fair Value Measurements

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 in selling 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 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 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 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 current market conditions.

Fair Value Hierarchy

In accordance with this guidance, 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.

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 December 31, 2019 and 2018, 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 December 31, 2019				
U.S. treasury notes and bonds	$ 44,978	$ -	$ -	$ 44,978
U.S. government agency and government sponsored enterprise (GSE) debt securities	-	30,457	-	30,457
U.S. government agency pool securities	-	173,497	-	173,497
U.S. government agency or GSE	-	128,198	-	128,198
Total fair value of securities	44,978	332,152	-	377,130
Other assets:				
MSRs	-	-	1,704	1,704
Total fair value	$ 44,978	$ 332,152	$ 1,704	$ 378,834
At December 31, 2018				
U.S. treasury notes and bonds	$ 54,160	$ -	$ -	$ 54,160
U.S. government agency and government sponsored enterprise (GSE) debt securities	-	44,750	-	44,750
U.S. government agency pool securities	-	211,372	-	211,372
U.S. government agency or GSE	-	70,760	-	70,760
Total fair value of securities	54,160	326,882	-	381,042
Other assets:				
MSRs	-	-	1,778	1,778
Total fair value	$ 54,160	$ 326,882	$ 1,778	$ 382,820

There were no liabilities measured at fair value on a recurring basis as of December 31, 2019 and 2018.

During the periods ended December 31, 2019 and 2018, the changes in Level 3 assets (consisting solely of MSRs) measured at fair value on a recurring basis are as follows:

	Years Ended December 31,	
	2019	2018
Beginning balance	$ 1,778	$ 1,903
Realized and unrealized net gains:		
Included in net income	(74)	(125)
Ending balance	$ 1,704	$ 1,778

The valuation technique used for Level 3 MSRs is their discounted cash flow. Inputs considered in determining Level 3 pricing include the anticipated prepayment rates, discount rates, and cost to service. Significant increases or decreases in any of those inputs in isolation would result in a significantly lower or higher fair value measurement.

The following table presents quantitative information about the valuation technique and unobservable inputs applied to Level 3 fair value measurements for financial instruments measured at fair value on a recurring basis:

	Estimated Fair Value	Valuation Technique	Unobservable Inputs	Range of Inputs	Weighted Average Rate
December 31, 2019					
Financial instrument:					
MSRs	$ 1,704	Discounted Cash Flow	Discount Rate	7.51% - 8.47%	7.70%
			Weighted Average Prepayment Rate (Public Securities Association)	125%	
December 31, 2018					
Financial instrument:					
MSRs	$ 1,778	Discounted Cash Flow	Discount Rate	8.39% - 9.12%	8.50%
			Weighted Average Prepayment Rate (Public Securities Association)	125%	

There were no transfers into or out of the Bank's Level 3 financial instruments for the periods ended December 31, 2019 and 2018.

The valuation techniques for assets measured at fair value on a recurring basis are as follows:

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, equity securities, Treasury notes and bonds.

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 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 December 31, 2019 and 2018, the Bank did not have any Level 3 investment securities.

Mortgage Servicing Rights

The fair value measurement of mortgage servicing rights is based upon quoted prices, if available. If quoted prices are not available, fair values are measured using independent pricing models or other model-based valuation techniques that incorporate assumptions that market participants would use in estimating the fair value of servicing rights. The most important of these assumptions is the interest rate used in discounting the future cash flows into their present value. Other assumptions might include estimates of prepayment speeds, costs to service, escrow account earnings, contractual servicing fee income, prepayment and late fees, among other considerations. The Bank's mortgage servicing rights are considered a Level 3 measurement at December 31, 2019 and 2018.

Assets Measured at 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 financial condition by caption and by level in the fair value hierarchy at December 31, 2019 and 2018, 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
December 31, 2019				
Other assets				
Other real estate owned	$ -	$ -	$ 8	$ 8
December 31, 2018				
Other assets				
Other real estate owned	$ -	$ -	$ 1,543	$ 1,543

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:

	Carrying Amount	Estimated fair value Level 1	Level 2	Level 3
		(Dollars in thousands)		
December 31, 2019				
Financial assets:				
Cash and cash equivalents	$ 131,716	$ 131,716	$ -	$ -
Restricted cash	400	400	-	-
Federal Home Loan Bank stock	2,267	-	2,267	-
Investment securities held-to-maturity	49,984	-	50,204	-
Loans, net	1,275,272	-	-	1,310,822
Total	$ 1,459,639	$ 132,116	$ 52,471	$ 1,310,822
Financial liabilities:				
Deposits	1,729,906	-	-	1,733,072
Total	$ 1,729,906	$ -	$ -	$ 1,733,072
December 31, 2018				
Financial assets:				
Cash and cash equivalents	$ 155,095	$ 155,095	$ -	$ -
Restricted cash	400	400	-	-
Federal Home Loan Bank stock	2,356	-	2,356	-
Investment securities held-to-maturity	68,088	-	67,477	-
Loans, net	1,212,141	-	-	1,212,289
Total	$ 1,438,080	$ 155,495	$ 69,833	$ 1,212,289
Financial liabilities:				
Deposits	$ 1,728,823	$ -	$ -	$ 1,731,830
Total	$ 1,728,823	$ -	$ -	$ 1,731,830

During the periods ended December 31, 2019 and 2018, the changes in Level 3 loans and deposits measured at fair value on a non-recurring basis are as follows:

	Years Ended December 31, 2019	2018
Beginning loan balance	$ 1,212,289	$ 1,202,817
Net issuances	98,533	9,472
Ending loan balance	$ 1,310,822	$ 1,212,289

	Years Ended December 31, 2019	2018
Beginning deposit balance	$ 1,731,830	$ 1,816,773
Net deposits	1,242	(84,943)
Ending deposit balance	$ 1,733,072	$ 1,731,830

The valuation technique used for Level 3 loans and deposits is their discounted cash flow. Inputs considered in determining Level 3 pricing include the respective discount rates. Significant increases or decreases in those inputs in isolation would result in a significantly lower or higher fair value measurement.

The following table presents quantitative information about the valuation technique and unobservable inputs applied to Level 3 fair value measurements for financial instruments measured at fair value on a non-recurring basis:

		Estimated Fair Value	Valuation Technique	Unobservable Inputs	Range of Inputs	Weighted Average Rate
December 31, 2019						
Financial instrument:						
Loans	$	1,310,822	Discounted Cash Flow	Discount Rate	6.77% - 7.69%	7.39%
Deposits	$	1,733,072	Discounted Cash Flow	Discount Rate	0.13% - 0.88%	0.15%
December 31, 2018						
Financial instrument:						
Loans	$	1,212,289	Discounted Cash Flow	Discount Rate	6.88% - 7.68%	7.28%
Deposits	$	1,731,830	Discounted Cash Flow	Discount Rate	0.13% - 0.88%	0.16%

The following methods were used by the Company in estimating fair value for its financial instruments not previously disclosed:

Cash, Cash Equivalents and Restricted Cash, including Interest Bearing Deposits in Banks

The carrying amount of cash and short-term instruments approximates fair value based on the short-term nature of the assets. Fair values for interest-bearing deposits that reprice frequently are based upon carrying value. Fair values of other interest bearing deposits with longer terms are estimated using discounted cash flow analyses based on current rates for similar types of deposits.

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.

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 market interest rates currently 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 FHLB advances maturing within ninety days approximate their fair values. We had no outstanding short-term borrowings at December 31, 2018 or 2019.

Long-Term Borrowings

Fair value of FHLB advances maturing after ninety days is determined based on expected present value techniques based on current market rates for advances with similar terms and remaining maturities. We had no outstanding long-term borrowings at December 31, 2018 or 2019.

Accrued Interest

The carrying amount of accrued interest approximates fair value due to its short-term nature.

Note 20 – Leases

The Bank leases certain land, office spaces, and storage spaces. Leases with an initial term of 12 months or less are not recorded on the balance sheet. Instead, the Bank recognizes lease expense for these leases on a straight-line basis over the lease term.

Most leases include one or more options to renew, with renewal terms that can extend the lease term from one to 50 years or more. The exercise of lease renewal options is at our sole discretion. The depreciable life of assets and leasehold improvements are limited by the expected lease terms, unless there is a transfer of title or purchase option reasonably certain of exercise.

Certain of our lease agreements include rental payments based on a percentage of the prevailing market value of the lease and the average of the Treasury Bill Rate and the Guam Consumer Price Index figure, and others include rental payments adjusted periodically for inflation. The Bank's lease agreements do not contain any material residual value guarantees or material restrictive covenants.

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 year ended December 31, 2019 and 2018, were $354 thousand, and $350 thousand respectively.

Additionally, the Bank leases office space to third parties, with original lease terms ranging from 1 to 3 years with option periods ranging up to 12 years. At December 31, 2019, minimum future rents to be received under non-cancelable operating sublease agreements were $34 thousand and $8 thousand for the periods ending December 31, 2020 and 2021, respectively.

The cash flow from operating leases included in the measurement of lease liabilities during December 31, 2019, was $2.4 million.

The following table summarizes the lease-related assets and liabilities recorded as part of other assets and other liabilities in our consolidated statements of financial condition at December 31, 2019:

		December 31, 2019
Assets		
Operating lease right-of-use assets	$	29,898
Total lease assets	$	29,898
Liabilities		
Current		
Operating	$	2,362
Noncurrent		
Operating		27,797
Total lease liabilities	$	30,159

The operating lease cost, including short-term lease and variable lease costs, was $3,706 thousand at December 31, 2019, and short term leases was $31 thousand during the same period. Short term leases include one lease that is less than 12 months.

The following table provides the maturities of lease liabilities at December 31, 2019:

		Operating Leases (a)		Total
2020	$	3,426	$	3,426
2021		3,221		3,221
2022		2,700		2,700
2023		2,486		2,486
2024		2,334		2,334
After 2024		40,238		40,238
Total lease payments	$	54,405	$	54,405
Less: Interest (b)		24,246		24,246
Present value of lease liabilities (c)	$	30,159	$	30,159

Note: For leases commencing prior to 2019, minimum lease payments exclude payments to landlords for real estate taxes and common area maintenance.

(a) Operating lease payments include $25.9 million related to options to extend lease terms that are reasonably certain of being exercised.

(b) Calculated using the incremental borrowing rate based on the lease term for each lease.

(c) Includes the current portion of $2.4 million for operating leases.

The following table provides the weighted-average lease term and discount rate at December 31, 2019:

	December 31, 2019
Weighted-average remaining lease term (years)	
Operating leases	24.1
Weighted-average discount rate	
Operating leases	4.07%

Note 21 – Revenue Recognition

On January 1, 2018, the Company adopted ASU No. 2014-09, *"Revenue from Contracts with Customers" ("ASC 606")* and all subsequent ASUs that modified ASC 606. The Company's revenue is primarily comprised of net interest income on financial assets less interest paid on financial liabilities, which are excluded from the scope of ASU No. 2014-09. The Company evaluated its various revenue streams and determined that service charges on deposit accounts and online fees are within the scope of ASC 606. The fees charged from service charges on deposit accounts are based on services provided or transactions performed, and the online fees associated with business accounts are billed at the end of each month or upon occurrence. Neither revenue stream results in a difference from historic revenue recognition practices. The revenue earned from these services and its percentage of total revenue for the year ended December 31, 2019, were $4.6 million and 4.2% for service charges on deposit accounts, and $883 thousand and 0.8% for online fees, respectively, as compared to $4.8 million and 4.6% for service charges on deposit accounts, and $822 thousand and 0.8% for online fees, respectively at December 31, 2018. The Company has determined that the result of applying this ASU to the revenue streams affected has not been material to the Company's consolidated financial statements.

Note 22 – Subordinated Debt

On June 27, 2019, the Company issued $15.0 million in aggregate principal amount of its 6.35% Fixed-to-Floating Rate Subordinated Notes due June 30, 2029 (the "Notes").

The Notes have a ten-year term and initially bear interest at a fixed annual rate of 6.35%. Beginning June 30, 2024, the interest rate will reset quarterly to the then-current three-month LIBOR plus 466 basis points. The Company is required to pay interest only semi-annually during the fixed period, and quarterly during the floating rate period. The principal sum of the Notes plus any unpaid interest are due on the maturity date.

The Notes are unsecured, subordinated obligations of the Company only and are not obligations of, and are not guaranteed by, any subsidiary of the Company. The Notes are subordinate to the Company's current and future senior indebtedness.

Note 23 – Subsequent Events

In mid-January of 2020, a new disease in central China began to spread suddenly, at first locally but subsequently nationally, regionally and globally. Identified as a novel coronavirus, it quickly became evident that this new virus, designated as COVID-19, is both highly contagious and can be debilitating or fatal to those people who become infected. Starting slowly, with a limited number of people contracting the virus and a few people dying from complications, the wide distribution of infections and a rising death toll have caused local and national governments to implement various efforts to combat the threat. Many of those efforts, from limiting or prohibiting travel to requiring local or broader quarantines, are expected to have adverse impacts on local, national and the global economies. Due to the Company's concerns for the health and safety of its customers and employees, the Bank has temporarily closed one of its branches in the Commonwealth of the Northern Mariana Islands and ten of its branches in Guam (including two that are scheduled to close permanently in April 2020), and limited the number of customers allowed to be in its remaining facilities at any one time to 50. The Bank has also implemented a telecommuting program for those personnel who are able to perform their responsibilities remotely, provided the computer hardware and software needed to support those tasks, and established teleconferencing capabilities to reduce the number of people in attendance at all of its larger group meetings. In recognition of the potential difficulties that may be faced by our commercial and consumer customers, the Bank has initiated a temporary program under which affected customers may have their loan payments deferred or otherwise adjusted. As of the date of this filing, the current program applies to both commercial and consumer loans, and only for a period of up to three months. Although these actions taken in response to the heightened risks posed by COVID-19 are costly, it is not possible at the time of this filing to estimate the final consequences of these impacts on economic performance or the results of the Company's operations, its condition or its cash flows.

Exhibit 23.01

Consent of Independent Registered Public Accounting Firm

We consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 333-196854 and 333-182615) of BankGuam Holding Company of our report dated March 19, 2020 relating to the consolidated financial statements of BankGuam Holding Company appearing in the Annual Report on Form 10-K of BankGuam Holding Company for the year ended December 31, 2019.

/s/ Squar Milner LLP

San Diego, California

March 19, 2020

Exhibit 31.01

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a) AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Joaquin P.L.G. Cook, certify that:

1. I have reviewed this Annual Report on Form 10-K of BankGuam Holding Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 19, 2020

/s/ JOAQUIN P.L.G. COOK
Joaquin P.L.G. Cook
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.02

CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER PURSUANT TO EXCHANGE ACT RULE 13a-14(a)/15d-14(a) AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Francisco M. Atalig, certify that:

1. I have reviewed this Annual Report on Form 10-K of BankGuam Holding Company;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

    c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

    d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: March 19, 2020

/s/ FRANCISCO M. ATALIG
Francisco M. Atalig
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.01

CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER AND PRINCIPAL FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT

The certification set forth below is being submitted in connection with the Annual Report on Form 10-K of BankGuam Holding Company for the purpose of complying with Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934 and Section 1350 of Chapter 63 of Title 18 of the United States Code.

Joaquin P.L.G. Cook, the President and Chief Executive Officer of BankGuam Holding Company, and Francisco M. Atalig, the Senior Vice President and Chief Financial Officer of BankGuam Holding Company, each certifies that, to the best of their knowledge:

1. the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of BankGuam Holding Company.

Date: March 19, 2020

By: /s/ JOAQUIN P.L.G. COOK
Joaquin P.L.G. Cook
President and Chief Executive Officer

Date: March 19, 2020

By: /s/ FRANCISCO M. ATALIG
Francisco M. Atalig
Senior Vice President and Chief Financial Officer