

The Bank of N. T. Butterfield & Son Limited

# Interim

## Q2 2013

Financial Results for the six months ended  
30 June 2013



Butterfield

# The Bank of N.T. Butterfield & Son Limited

## Unaudited Consolidated Balance Sheet

(in thousands of Bermuda dollars)

	As at	
	30 June 2013	31 December 2012
<b>Assets</b>		
Cash and demand deposits with banks	410,811	367,050
Cash equivalents	1,275,950	1,175,476
Total cash and cash equivalents	1,686,761	1,542,526
Short-term investments	66,429	76,213
Debt and equity securities		
Trading	61,096	61,785
Available for sale	2,413,261	2,580,577
Held to maturity	294,418	239,342
Total investments in debt and equity securities	2,768,775	2,881,704
Loans, net of allowance for credit losses	4,103,359	3,955,960
Premises, equipment and computer software	239,356	243,321
Accrued interest	23,110	18,975
Goodwill and intangible assets	19,469	22,276
Investments in affiliates	18,509	18,637
Other real estate owned	32,772	34,360
Other assets	38,119	39,037
<b>Total assets</b>	<b>8,996,659</b>	<b>8,833,009</b>
<b>Liabilities</b>		
Customers deposits		
Non-interest bearing	944,489	918,814
Interest bearing	6,635,362	6,347,958
Total customer deposits	7,579,851	7,266,772
Bank deposits	70,121	126,466
Total deposits	7,649,972	7,393,238
Securities sold under agreement to repurchase	150,889	109,021
Employee future benefits	102,102	103,135
Accrued interest	3,987	2,795
Preference Share dividends payable	599	662
Other liabilities	97,076	106,984
Total other liabilities	354,653	322,597
Subordinated capital	207,000	260,000
<b>Total liabilities</b>	<b>8,211,625</b>	<b>7,975,835</b>
<b>Shareholders' equity</b>		
Common Share capital (BMD 0.01 par; authorised Shares 26,000,000,000)		
issued and outstanding: 549,765,599 (2012: 549,677,803)	5,497	5,496
Preference Share capital (USD 0.01 par; USD 1,000 liquidation Preference)		
issued and outstanding: 184,561 (2012: 195,578)	2	2
Contingent Value Convertible Preference Share capital (USD 0.01 par)		
issued and outstanding: 7,166,936 (2012: 7,254,732)	72	73
Additional paid-in capital	1,342,914	1,355,689
Accumulated deficit	(472,829)	(482,796)
Less: Treasury Common Shares: 7,667,261 Shares (2012: 7,066,586 Shares)	(9,820)	(8,767)
Accumulated other comprehensive loss	(80,802)	(12,523)
<b>Total Shareholders' equity</b>	<b>785,034</b>	<b>857,174</b>
<b>Total liabilities and Shareholders' equity</b>	<b>8,996,659</b>	<b>8,833,009</b>

The accompanying notes are an integral part of these Consolidated Financial Statements.

# The Bank of N.T. Butterfield & Son Limited

## Unaudited Consolidated Statements of Operations

(in thousands of Bermuda dollars, except per Share data)

	For the three month period ended		For the six month period ended	
	30 June 2013	30 June 2012	30 June 2013	30 June 2012
<b>Non-interest income</b>				
Asset management	4,682	6,121	9,176	12,278
Banking	7,633	8,064	14,846	15,831
Foreign exchange revenue	7,464	7,395	14,530	14,032
Trust	7,270	6,560	14,872	14,320
Custody and other administration services	2,663	2,570	5,127	5,373
Other non-interest income	1,303	1,743	2,329	3,156
<b>Total non-interest income</b>	<b>31,015</b>	<b>32,453</b>	<b>60,880</b>	<b>64,990</b>
<b>Interest income</b>				
Loans	46,658	48,961	91,671	97,760
Investments	14,909	12,270	28,848	24,299
Deposits with banks	1,170	1,439	2,407	2,724
<b>Total interest income</b>	<b>62,737</b>	<b>62,670</b>	<b>122,926</b>	<b>124,783</b>
<b>Interest expense</b>				
Deposits	4,888	5,567	9,773	11,273
Subordinated capital	2,741	3,124	5,830	6,349
Securities sold under repurchase agreements	36	-	78	-
<b>Total interest expense</b>	<b>7,665</b>	<b>8,691</b>	<b>15,681</b>	<b>17,622</b>
<b>Net interest income before provision for credit losses</b>	<b>55,071</b>	<b>53,979</b>	<b>107,245</b>	<b>107,161</b>
Provision for credit losses	(3,198)	(4,941)	(7,833)	(8,379)
<b>Net interest income after provision for credit losses</b>	<b>51,873</b>	<b>49,038</b>	<b>99,412</b>	<b>98,782</b>
Net realised / unrealised (losses) gains on trading investments	(298)	(404)	(35)	38
Net realised gains (losses) on available for sale investments	16	(276)	56	1,801
Net realised / unrealised losses on other real estate owned	(364)	(759)	(472)	(759)
Net gain on sale of affiliate	-	4,250	-	4,250
Net other gains	13,085	113	13,492	123
<b>Total other gains</b>	<b>12,439</b>	<b>2,924</b>	<b>13,041</b>	<b>5,453</b>
<b>Total net revenue</b>	<b>95,327</b>	<b>84,415</b>	<b>173,333</b>	<b>169,225</b>
<b>Non-interest expense</b>				
Salaries and other employee benefits	31,001	34,920	64,248	69,967
Technology and communications	13,202	14,723	26,511	28,993
Property	5,921	6,424	11,747	12,894
Professional and outside services	3,280	3,306	6,531	7,588
Non-income taxes	3,298	3,310	6,826	6,769
Amortisation of intangible assets	818	1,276	1,662	2,559
Marketing	1,065	1,066	1,940	2,292
Other expenses	3,525	3,362	7,207	6,959
<b>Total non-interest expense</b>	<b>62,110</b>	<b>68,387</b>	<b>126,672</b>	<b>138,022</b>
<b>Net income before income taxes from continuing operations</b>	<b>33,217</b>	<b>16,028</b>	<b>46,661</b>	<b>31,203</b>
Income tax (expense) benefit	(294)	12	(451)	(600)
<b>Net income from continuing operations</b>	<b>32,923</b>	<b>16,040</b>	<b>46,210</b>	<b>30,603</b>
<b>Discontinued operations</b>				
Income from discontinued operations before income taxes	-	322	-	546
Income tax expense	-	(120)	-	(226)
<b>Net income from discontinued operations</b>	<b>-</b>	<b>202</b>	<b>-</b>	<b>320</b>
<b>Net income</b>	<b>32,923</b>	<b>16,242</b>	<b>46,210</b>	<b>30,923</b>

### Earnings per Common Share

Basic Earnings per Share	0.05	0.02	0.06	0.04
Diluted Earnings per Share	0.05	0.02	0.06	0.04
Basic Earnings per Share from continuing operations	0.05	0.02	0.06	0.04
Diluted Earnings per Share from continuing operations	0.05	0.02	0.06	0.04

The accompanying notes are an integral part of these Consolidated Financial Statements.

**The Bank of N.T. Butterfield & Son Limited**  
**Unaudited Consolidated Statements of Comprehensive Income (Loss)**

*(in thousands of Bermuda dollars)*

	For the three month period ended		For the six month period ended	
	<b>30 June 2013</b>	30 June 2012	<b>30 June 2013</b>	30 June 2012
<b>Net income</b>	<b>32,923</b>	16,242	<b>46,210</b>	30,923
<b>Other comprehensive income (loss)</b>				
Net unrealised (loss) gains on translation of net investment in foreign operations	77	(413)	(2,319)	(306)
Net unrealised (loss) gains available for sale investment	(58,934)	2,326	(64,517)	19,634
Employee future benefits adjustments	(1,091)	(870)	(1,443)	(1,740)
Other comprehensive (loss) income	(59,948)	1,043	(68,279)	17,588
<b>Total comprehensive (loss) income</b>	<b>(27,025)</b>	17,285	<b>(22,069)</b>	48,511

The accompanying notes are an integral part of these Consolidated Financial Statements.

# The Bank of N.T. Butterfield & Son Limited

## Unaudited Consolidated Statements of Changes in Shareholders' Equity

For the six months ended

	30 June 2013		30 June 2012	
	Number of shares	In thousands of Bermuda dollars	Number of shares	In thousands of Bermuda dollars
<b>Common Share capital issued and outstanding</b>				
Balance at beginning of period	549,677,803	5,496	549,468,349	5,494
Conversion of Contingent Value Convertible Preference Shares	87,796	1	63,010	1
<b>Balance at end of period</b>	<b>549,765,599</b>	<b>5,497</b>	<b>549,531,359</b>	<b>5,495</b>
<b>Preference Shares</b>				
Balance at beginning of period	195,578	2	200,000	2
Repurchase and cancellation of Preference Shares	(11,017)	-	-	-
<b>Balance at end of period</b>	<b>184,561</b>	<b>2</b>	<b>200,000</b>	<b>2</b>
<b>Contingent Value Convertible Preference Shares</b>				
Balance at beginning of period	7,254,732	73	7,789,087	75
Conversion to Common Shares	(87,796)	(1)	(63,010)	(1)
<b>Balance at end of period</b>	<b>7,166,936</b>	<b>72</b>	<b>7,726,077</b>	<b>74</b>
<b>Additional paid-in capital</b>				
Balance at beginning of period		1,355,689		1,377,556
Stock option plan expense		3,059		2,503
Share based compensation settlements		(2,250)		(12,446)
Reduction of carrying value on repurchase of Preference Shares		(11,017)		-
Premium paid on repurchase of Preference Shares		(2,567)		-
<b>Balance at end of period</b>		<b>1,342,914</b>		<b>1,367,613</b>
<b>Accumulated deficit</b>				
Balance at beginning of period		(482,796)		(490,377)
Net income for period		46,210		30,923
Common Share cash dividends declared and paid (\$0.05 per share)		(27,555)		-
Cash dividends declared on Preference Shares		(7,714)		(8,000)
Preference Shares guarantee fee		(974)		(1,000)
<b>Balance at end of period</b>		<b>(472,829)</b>		<b>(468,454)</b>
<b>Treasury Common Shares</b>				
Balance at beginning of period	7,066,586	(8,767)	2,163,958	(21,723)
Share-based settlement	(103,450)	151	-	114
Purchases of Treasury Shares	2,516,398	(3,454)	533,414	(662)
Share based compensation settlements	(1,812,273)	2,250	(1,239,565)	12,446
<b>Balance at end of period</b>	<b>7,667,261</b>	<b>(9,820)</b>	<b>1,457,807</b>	<b>(9,825)</b>
<b>Accumulated other comprehensive loss</b>				
Balance at beginning of period		(12,523)		(41,302)
Other comprehensive (loss) income		(68,279)		17,588
<b>Balance at end of period</b>		<b>(80,802)</b>		<b>(23,714)</b>
<b>Total Shareholders' equity</b>		<b>785,034</b>		<b>871,191</b>

The accompanying notes are an integral part of these Consolidated Financial Statements.

# The Bank of N.T. Butterfield & Son Limited

## Unaudited Consolidated Statements of Cash Flows

(in thousands of Bermuda dollars)

	For the six month period ended	
	30 June 2013	30 June 2012
<b>Cash flows from operating activities</b>		
Net income	46,210	30,923
Less: Net income from discontinued operations	-	(320)
<b>Net income from continuing operations</b>	<b>46,210</b>	<b>30,603</b>
Adjustments to reconcile net income to operating cash flows:		
Depreciation and amortisation	22,929	22,756
Net loss on sale of customer relationships intangible assets	-	515
Decrease in carrying value of investments in affiliates	128	(639)
Share-based payments and settlements	3,210	2,617
Gain on sale of premises and equipment	-	(300)
Net gain on sale of affiliate	-	(4,250)
Net realised / unrealised losses on other real estate owned	472	759
Net realised gains on available for sale securities	(56)	(1,801)
Realised gains on legal settlement	(13,108)	-
Provision for credit losses	7,833	8,379
<b>Changes in operating assets and liabilities:</b>		
Increase in accrued interest receivable	(4,322)	(586)
Increase in other assets	(323)	(674)
Increase (decrease) in accrued interest payable	1,249	(1,454)
Decrease in other liabilities and employee future benefits	(394)	(6,635)
	63,828	49,290
Net change in trading investments	358	424
<b>Cash provided by operating activities from continuing operations</b>	<b>64,186</b>	<b>49,714</b>
<b>Cash flows from investing activities</b>		
Net decrease (increase) in short-term investments	8,933	(13,774)
Proceeds from legal settlement	13,108	-
Net proceeds on sale of affiliate	-	18,464
Net proceeds on sale of customer relationships intangible assets	-	1,428
Additions to premises, equipment and computer software	(8,056)	(7,174)
Proceeds from other real estate owned	2,107	1,133
Net increase in loans	(222,822)	(49,623)
Held to maturity investments: proceeds from pay downs	11,536	1,624
Held to maturity investments: purchases	(67,172)	(135,298)
Available for sale investments: proceeds from maturities and pay downs	596,327	493,357
Available for sale investments: proceeds from sales	432,089	347,665
Available for sale investments: purchases	(980,786)	(1,043,612)
<b>Cash used in investing activities from continuing operations</b>	<b>(214,736)</b>	<b>(385,810)</b>
<b>Cash flows from financing activities</b>		
Net increase in demand and term deposit liabilities	390,997	5,152
Net increase in securities sold under agreement to repurchase	41,868	-
Repayment of subordinated capital	(53,000)	(7,946)
Preference Shares repurchased	(13,673)	-
Common Shares repurchased	(3,454)	(662)
Cash dividends paid on Common and Contingent Value Convertible Preference Shares	(27,555)	-
Cash dividends paid on Preference Shares	(7,688)	(8,000)
Preference Shares guarantee fee paid	(974)	(1,000)
<b>Cash provided by (used in) financing activities from continuing operations</b>	<b>326,521</b>	<b>(12,456)</b>
Net effect of exchange rates on cash and cash equivalents	(31,736)	7,591
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>144,235</b>	<b>(340,961)</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>1,542,526</b>	<b>1,902,726</b>
<b>Cash and cash equivalents at end of period</b>	<b>1,686,761</b>	<b>1,561,765</b>
<b>Supplemental disclosure of Non-cash investing activities</b>		
Fair value of properties added to Other Real Estate Owned	1,087	1,341

The accompanying notes are an integral part of these Consolidated Financial Statements.

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements

(in thousands of Bermuda dollars)

### Note 1: Significant Accounting Policies

The accompanying unaudited interim consolidated financial statements of The Bank of N.T. Butterfield & Son Limited (the "Bank") have been prepared in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and should be read in conjunction with the Bank's audited financial statements for the year ending 31 December 2012. To facilitate comparison of information across periods, certain reclassifications have been made to prior period amounts to conform to the current period's presentation.

In the opinion of Management, these unaudited interim consolidated financial statements reflect all adjustments (consisting principally of normal recurring accruals) considered necessary for a fair presentation of the Bank's financial position and results of operations as at the end of and for the periods presented. The Bank's results for interim periods are not necessarily indicative of results for the full year.

The preparation of financial statements in conformity with U.S. GAAP requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. While Management believes that the amounts included in the unaudited interim consolidated financial statements reflect its best estimates and assumptions, actual results could differ from those estimates. The Bank's principal estimates include:

- i. Allowance for credit losses
- ii. Fair value and impairment of financial instruments
- iii. Impairment of long-lived assets
- iv. Impairment of goodwill
- v. Income taxes
- vi. Employee future benefits
- vii. Share-based payments

The following accounting developments were issued during the six month period ended 30 June 2013:

#### Disclosures About Offsetting Asset and Liabilities

In December 2011, the FASB issued an Accounting Standards Update that required entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. Entities are required to disclose both gross information and net information about Instruments and transactions eligible for offset in the statement of financial position and those which are subject to an agreement similar to a master netting arrangement. The new guidance became effective for all annual and interim periods beginning January 1, 2013. Additionally, entities are required to provide the disclosures for all comparative periods. In January 2013, the FASB issued another Accounting Standards Update to clarify the instruments and transactions to which the guidance in the previously issued Accounting Standards Update would apply. The adoption of the guidance in these Accounting Standards Updates did not have an impact on our financial position or results of operations.

#### Reclassification out of Accumulated Other Comprehensive Income

In February 2013, the FASB issued an Accounting Standards Update that adds new disclosure requirements for items reclassified out of accumulated other comprehensive income. The new guidance was effective for all annual and interim periods beginning 1 January 2013 and was applied prospectively. The adoption of this guidance did not have an impact on our financial position or results of operations. The new disclosure requirements of this Accounting Standards Update are included in Note 18: Accumulated Other Comprehensive Income to the Consolidated Financial Statements.

#### Obligations Arising from Joint and Several Liability Arrangement

During February 2013, the FASB issued an accounting standard update concerning the obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date. The objective of the amendment in the update is to provide guidance for the recognition, measurement, and disclosure of obligations resulting from joint and several liability arrangements. The guidance will require an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation within the scope of the guidance is fixed at the reporting date. The guidance will also require an entity to disclose the nature and amount of the obligation as well as other information about the obligations. The amendments will be effective for periods beginning after 15 December 2013, and must be shown for all periods presented on the Balance Sheet (i.e., applied retrospectively). This new guidance is not expected to have a material impact on the Bank's consolidated financial condition or results of operations.

#### Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Group of Assets

In March 2013, the FASB issued the final guidance related to the release of a cumulative translation adjustment ("CTA") upon derecognition of subsidiaries or group of assets within a foreign entity into net income. The guidance clarifies that when a parent ceases to have a controlling financial interest in a subsidiary or group of assets within a foreign entity and the sale represents the complete or substantially complete liquidation of the investment in the foreign entity, or when a parent loses its controlling financial interest in an investment in a foreign entity, it should release the CTA into net income. The standard also requires the release of CTA into net income upon acquiring a controlling interest in a foreign entity that was accounted for under equity method investment prior to obtaining control, and consistent with current U.S. GAAP in this area, upon a partial sale of an equity method investment. The guidance is effective prospectively from 1 January 2014. The adoption of this guidance is not expected to have a significant impact on our financial statements.

## The Bank of N.T. Butterfield & Son Limited

### Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

#### Note 2: Discontinued Operations

On 7 May 2012 the Bank announced its agreement to sell Butterfield Bank (Barbados) Limited, a wholly-owned subsidiary which is the entire Barbados segment, to First Citizens Bank Limited. The sale was completed on 27 August 2012 with gross proceeds, subject to normal adjustments, of \$45 million, resulting in a net gain of \$7.2 million included in net income from discontinued operations in the Consolidated Statements of Operations and Comprehensive Income.

The Bank has determined that the requirements have been met to report the results of the subsidiary sold as discontinued operations effective from the second quarter in 2012. Prior periods have been restated for the discontinued operation.

The following table summarises the results of the Barbados operating segment for the six months ended:

	For the three month period ended		For the six month period ended	
	30 June 2013	30 June 2012	30 June 2013	30 June 2012
Non-interest income	-	568	-	1,291
Net interest income	-	2,725	-	5,458
Provision for credit losses	-	(59)	-	(424)
<b>Revenue before gains (losses)</b>	-	3,234	-	6,325
Gains (losses)	-	9	-	9
<b>Total net revenue</b>	-	3,243	-	6,334
Non-interest expenses	-	(2,921)	-	(5,788)
<b>Net income before income taxes</b>	-	322	-	546
Income tax expense	-	(120)	-	(226)
<b>Net income from discontinued operations</b>	-	202	-	320

#### Note 3: Cash and Cash Equivalents

	30 June 2013			31 December 2012		
	Bermuda	Non-Bermuda	Total	Bermuda	Non-Bermuda	Total
<b>Unrestricted</b>						
<b>Non-interest earning</b>						
Cash and demand deposits	184,703	42,273	226,976	172,179	44,425	216,604
<b>Interest earning</b>						
Demand deposits	231	183,604	183,835	143	150,303	150,446
Cash equivalents	335,167	940,783	1,275,950	334,835	840,641	1,175,476
Sub-total - Interest earning	335,398	1,124,387	1,459,785	334,978	990,944	1,325,922
<b>Total cash and cash equivalents</b>	<b>520,101</b>	<b>1,166,660</b>	<b>1,686,761</b>	<b>507,157</b>	<b>1,035,369</b>	<b>1,542,526</b>

#### Note 4: Short-term Investments

	30 June 2013			31 December 2012		
	Bermuda	Non-Bermuda	Total	Bermuda	Non-Bermuda	Total
<b>Unrestricted</b>						
<b>Interest earning</b>						
Term deposits maturing within three months	-	52,176	52,176	-	56,727	56,727
Term deposits maturing between three to six months	-	2,906	2,906	-	7,672	7,672
Term deposits maturing between six to twelve months	-	6,051	6,051	-	4,761	4,761
<b>Total unrestricted short-term investments</b>	-	61,133	61,133	-	69,160	69,160
<b>Affected by drawing restrictions related to minimum reserve and derivative margin requirements</b>						
<b>Interest earning</b>						
Demand deposits	5,189	107	5,296	6,942	111	7,053
<b>Total restricted short-term investments</b>	<b>5,189</b>	<b>107</b>	<b>5,296</b>	<b>6,942</b>	<b>111</b>	<b>7,053</b>
<b>Total short-term investments</b>	<b>5,189</b>	<b>61,240</b>	<b>66,429</b>	<b>6,942</b>	<b>69,271</b>	<b>76,213</b>



**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 5: Investments**

**Amortised cost, carrying amounts and estimated fair value**

The amortised cost, carrying amounts and fair values, are as follows:

	30 June 2013				31 December 2012			
	Amortised cost	Gross unrealised gains	Gross unrealised losses	Carrying amount / Fair value	Amortised cost	Gross unrealised gains	Gross unrealised losses	Carrying amount / Fair value
<b>Trading</b>								
Debt securities issued by non-US governments	3,995	655	-	4,650	4,301	930	-	5,231
Mutual funds	56,778	612	(944)	56,446	56,779	511	(736)	56,554
<b>Total trading</b>	<b>60,773</b>	<b>1,267</b>	<b>(944)</b>	<b>61,096</b>	<b>61,080</b>	<b>1,441</b>	<b>(736)</b>	<b>61,785</b>

**Available for sale**

Certificates of deposit	267,063	1,199	(32)	268,230	558,668	2,706	(14)	561,360
US government and federal agencies	1,418,612	10,845	(37,116)	1,392,341	1,156,307	23,613	(1,134)	1,178,786
Debt securities issued by non-US governments	83,761	349	(11)	84,099	89,609	438	(5)	90,042
Corporate debt securities guaranteed by non-US governments	-	-	-	-	32,021	5	-	32,026
Corporate debt securities	366,336	12,673	(193)	378,816	400,980	20,105	-	421,085
Asset-backed securities - Student loans	90,656	(26)	(3,068)	87,562	139,304	-	(3,203)	136,101
Mortgage backed securities - Commercial	155,945	-	(13,577)	142,368	130,526	231	(279)	130,478
Mortgage backed securities - Retail	24,826	-	(1,365)	23,461				
Pass-through note	28,336	7,998	-	36,334	30,404	242	-	30,646
Equity securities	118	-	(68)	50	126	-	(73)	53
<b>Total available for sale</b>	<b>2,435,653</b>	<b>33,038</b>	<b>(55,430)</b>	<b>2,413,261</b>	<b>2,537,945</b>	<b>47,340</b>	<b>(4,708)</b>	<b>2,580,577</b>

	30 June 2013				31 December 2012			
	Amortised cost / Carrying amount	Gross unrealised gains	Gross unrealised losses	Fair value	Amortised cost / Carrying amount	Gross unrealised gains	Gross unrealised losses	Fair value
<b>Held to maturity <sup>(1)</sup></b>								
US government and federal agencies	294,418	149	(9,927)	284,640	239,342	6,691	(1,240)	244,793
<b>Total held to maturity</b>	<b>294,418</b>	<b>149</b>	<b>(9,927)</b>	<b>284,640</b>	<b>239,342</b>	<b>6,691</b>	<b>(1,240)</b>	<b>244,793</b>

<sup>(1)</sup> For the periods ended 30 June 2013 and 31 December 2012 non-credit impairments recognised in AOCI for held to maturity investments was \$nil.

**Available for sale**

As at 30 June 2013, US government and federal agency investment securities classified as Available for sale with an amortised cost of \$340.3 million (31 December 2012: \$255.7 million) and fair value of \$334.8 million (31 December 2012: \$262.7 million) were pledged to secure Bank deposit products where the secured party did not have the right to sell or repledge the collateral.

US government and federal agency investment securities with an amortised cost of \$117.4 million (31 December 2012: \$120.9 million) and fair market value of \$112.4 million (31 December 2012: \$122.4 million) were pledged to secure repurchase agreements at 30 June 2013.

**Held to maturity**

As at 30 June 2013, US government and federal agency investment securities with an amortised cost of \$57.5 million (31 December 2012: \$45.7 million) and fair market value of \$53.4 million (31 December 2012: \$44.5 million) were pledged to secure Bank deposit products where the secured party did not have the right to sell or repledge the collateral.

US government and federal agency investment securities with an amortised cost of \$46.4 million (31 December 2012: \$nil) and fair market value of \$44.5 million (31 December 2012: \$nil) were pledged to secure repurchase agreements at 30 June 2013.

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 5: Investments (continued)

#### Unrealised loss positions

The following tables show the fair value and gross unrealised losses of the Bank's AFS and HTM investments with unrealised losses that are not deemed to be OTTI, aggregated by investment category and length of time that individual securities have been in a continuous unrealised loss position. Debt securities are categorised as being in a continuous loss position for "Less than 12 months" or "12 months or more" based on the point in time that the fair value declined below the cost basis.

30 June 2013	Less than 12 months		12 months or more			
	Fair value	Gross unrealised losses	Fair value	Gross unrealised losses	Total fair value	Total gross unrealised losses
Available for sale						
Certificates of deposit	83,440	(32)	-	-	83,440	(32)
US government and federal agencies	764,626	(36,572)	63,062	(544)	827,688	(37,116)
Debt securities issued by non-US governments	75,973	(11)	-	-	75,973	(11)
Corporate debt securities	21,091	(193)	-	-	21,091	(193)
Asset-backed securities - Student loans	-	-	127,311	(3,068)	127,311	(3,068)
Mortgage-backed securities - Commercial	142,368	(13,577)	-	-	142,368	(13,577)
Mortgage-backed securities - Retail	23,461	(1,365)	-	-	23,461	(1,365)
Equity securities	-	-	49	(68)	49	(68)
Total available-for-sale securities with unrealised losses	1,110,959	(51,750)	190,422	(3,680)	1,301,381	(55,430)
Held to maturity						
US government and federal agencies	243,819	(9,927)	-	-	243,819	(9,927)
Total held-to-maturity securities with unrealised losses	243,819	(9,927)	-	-	243,819	(9,927)

31 December 2012	Less than 12 months		12 months or more			
	Fair value	Gross unrealised losses	Fair value	Gross unrealised losses	Total fair value	Total gross unrealised losses
Available for sale						
Certificates of deposit	82,477	(14)	-	-	82,477	(14)
US government and federal agencies	191,492	(342)	65,792	(792)	257,284	(1,134)
Debt securities issued by non-US governments	56,797	(5)	-	-	56,797	(5)
Corporate debt securities guaranteed by non-US governments	-	-	-	-	-	-
Asset-backed securities - Student loans	-	-	136,101	(3,203)	136,101	(3,203)
Mortgage-backed securities - Commercial	92,306	(279)	-	-	92,306	(279)
Equity securities	-	-	53	(73)	53	(73)
Total available-for-sale securities with unrealised losses	423,072	(640)	201,946	(4,068)	625,018	(4,708)
Held to maturity						
US government and federal agencies	44,496	(1,240)	-	-	44,496	(1,240)
Total held-to-maturity securities with unrealised losses	44,496	(1,240)	-	-	44,496	(1,240)

The Bank does not believe that the investment securities that were in an unrealised loss position as of 30 June 2013, which was comprised of 123 securities, or, 57% of the portfolio by market value, represent an other-than-temporary impairment. Total gross unrealised losses were only 4% of the market value of affected securities and were primarily attributable to changes in market interest rates, relative to when the investment securities were purchased, and not due to the credit quality of the investment securities. The Bank does not intend to sell the investment securities that were in an unrealised loss position and it is not more likely than not that the Bank will be required to sell the investment securities before recovery of the amortised cost bases, which may be at maturity.

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 5: Investments (continued)

The following describes the process for identifying credit impairment in security types with the most significant unrealised losses as of 30 June 2013.

#### US government and federal agencies

As of 30 June 2013, gross unrealised losses on securities related to United States ("US") government and federal agencies were \$46.5 million (2012: \$1.6 million). Overall, Management believes that all the securities in this class do not have any credit losses, given the explicit and implicit guarantees provided by the US federal government.

#### Asset-backed securities – Student loans

As of 30 June 2013, gross unrealised losses on student loan asset-backed securities were \$3.1 million (2012: \$3.2 million). Asset-backed securities collateralised by student loans are primarily composed of securities collateralised by Federal Family Education Loan Program ("FFELP loans"). FFELP loans benefit from a federal government guarantee of at least 97% of defaulted principal and accrued interest, with additional credit support provided in the form of overcollateralisation, subordination and excess spread, which collectively total in excess of 100%. Accordingly, the vast majority of FFELP loan-backed securities are not exposed to traditional consumer credit risk.

#### Mortgage-backed securities – Commercial and Retail

As of 30 June 2013, gross unrealised losses on commercial and prime mortgage backed securities were \$13.6 million and \$1.4 million respectively (2012: \$0.3 million and \$nil) all of which related to securities that were in an unrealised loss position for less than 12 months and were only 9% of the market value of the affected securities which is consistent with changes in market interest rates. The Bank's commercial and prime mortgage-backed securities are predominantly rated "AAA" and possess significant subordination (a form of credit enhancement for the benefit of senior securities, expressed here as the percentage of pool losses that can occur before a senior asset-backed security will incur its first dollar of principal loss). No credit losses were recognised on these securities as Management does not believe these securities have any credit losses.

#### Contractual maturities

The following table presents the remaining contractual maturities of the Bank's securities. The remaining contractual principal maturities for the mortgage-backed securities (primarily US Government agencies) do not consider prepayments. Remaining expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations before the underlying mortgages mature.

30 June 2013	Remaining term to earlier of expected or contractual maturity						Carrying amount
	Within 3 months	3 to 12 months	1 to 5 years	5 to 10 years	Over 10 years	No specific maturity	
<b>Trading</b>							
Debt securities issued by non-US governments	1,054	189	1,044	1,424	939	-	4,650
Mutual funds	-	-	-	-	-	56,446	56,446
<b>Total trading</b>	<b>1,054</b>	<b>189</b>	<b>1,044</b>	<b>1,424</b>	<b>939</b>	<b>56,446</b>	<b>61,096</b>
<b>Available for sale</b>							
Certificates of deposit	137,982	99,121	31,127	-	-	-	268,230
US government and federal agencies	2	-	122,243	313,161	956,935	-	1,392,341
Debt securities issued by non-US governments	36,487	40,887	5,600	1,125	-	-	84,099
Corporate debt securities guaranteed by non-US governments	-	-	-	-	-	-	-
Corporate debt securities	1,222	-	377,594	-	-	-	378,816
Asset-backed securities - Student loans	-	-	2,238	74,057	11,267	-	87,562
Mortgage-backed securities - Commercial	-	-	-	133,160	9,208	-	142,368
Mortgage-backed securities - Retail	-	-	-	-	23,461	-	23,461
Pass-through note	-	-	-	36,334	-	-	36,334
Equity securities	-	-	-	-	-	50	50
<b>Total available-for-sale securities</b>	<b>175,693</b>	<b>140,008</b>	<b>538,802</b>	<b>557,837</b>	<b>1,000,871</b>	<b>50</b>	<b>2,413,261</b>
<b>Held to maturity</b>							
US government and federal agencies	178	-	-	19,033	275,207	-	294,418
<b>Total held-to-maturity securities</b>	<b>178</b>	<b>-</b>	<b>-</b>	<b>19,033</b>	<b>275,207</b>	<b>-</b>	<b>294,418</b>
<b>Total investments</b>	<b>176,925</b>	<b>140,197</b>	<b>539,846</b>	<b>578,294</b>	<b>1,277,017</b>	<b>56,496</b>	<b>2,768,775</b>
<b>Total by currency</b>							
US dollars	36,477	16,429	538,802	576,870	1,276,078	55,613	2,500,269
Other	140,448	123,768	1,044	1,424	939	883	268,506
<b>Total investments</b>	<b>176,925</b>	<b>140,197</b>	<b>539,846</b>	<b>578,294</b>	<b>1,277,017</b>	<b>56,496</b>	<b>2,768,775</b>

**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 5: Investments (continued)**

31 December 2012	Remaining term to earlier of expected or contractual maturity						
	Within 3 months	3 to 12 months	1 to 5 years	5 to 10 years	Over 10 years	No specific maturity	Carrying amount
<b>Trading</b>							
Debt securities issued by non-US governments	-	1,382	1,157	1,611	1,081	-	5,231
Mutual funds	-	-	-	-	-	56,554	56,554
<b>Total trading</b>	-	1,382	1,157	1,611	1,081	56,554	61,785
<b>Available for sale</b>							
Certificates of deposit	255,624	274,357	31,379	-	-	-	561,360
US government and federal agencies	-	-	162,545	361,476	654,765	-	1,178,786
Debt securities issued by non-US governments	32,473	50,081	5,600	1,888	-	-	90,042
Corporate debt securities guaranteed by non-US governments	32,026	-	-	-	-	-	32,026
Corporate debt securities	-	-	421,085	-	-	-	421,085
Asset-backed securities - Student loans	-	-	2,506	82,825	50,770	-	136,101
Mortgage-backed securities - Commercial	-	-	-	130,478	-	-	130,478
Pass-through note	-	-	-	30,646	-	-	30,646
Equity securities	-	-	-	-	-	53	53
<b>Total available for sale</b>	320,123	324,438	623,115	607,313	705,535	53	2,580,577
<b>Held to maturity</b>							
US government and federal agencies	-	-	-	11,003	228,339	-	239,342
<b>Total held-to-maturity securities</b>	-	-	-	11,003	228,339	-	239,342
<b>Total investments</b>	320,123	325,820	624,272	619,927	934,955	56,607	2,881,704
<b>Total by currency</b>							
US dollars	166,289	179,536	623,115	618,315	933,874	55,513	2,576,642
Other	153,834	146,284	1,157	1,612	1,081	1,094	305,062
<b>Total investments</b>	320,123	325,820	624,272	619,927	934,955	56,607	2,881,704

**Sale proceeds and realised gains (losses)**

During the six months ended 30 June 2013, the Bank disposed of:

- US agency securities totalling \$162.2 million in sale proceeds, resulting in gross realised gains of \$0.3 million and gross realised losses of \$0.5 million;
- Certificates of deposit totalling \$160.1 million in sale proceeds, resulting in gross realised gains of \$0.1 million;
- Corporate bonds totalling \$66.2 million in sale proceeds, resulting in gross realised gains of \$0.4 million; and
- Asset-backed securities totalling \$43.6 million in sale proceeds, resulting in gross realised losses of \$0.2 million.

During the six months ended 30 June 2012, the Bank disposed of:

- US agency securities totalling \$46.9 million in sale proceeds, resulting in gross realised gains of \$0.5 million.
- Corporate bonds totalling \$249.1 million in sale proceeds, resulting in gross realised gains of \$1.0 million and a gross realised losses of \$0.2 million.
- Other securities totalling \$51.7 million in sale proceeds, resulting in gross realised gains of \$0.5 million.

**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 6: Loans**

The composition of the loan portfolio by collateral exposure at each of the indicated dates was as follows:

	30 June 2013			31 December 2012		
	Bermuda	Non-Bermuda	Total	Bermuda	Non-Bermuda	Total
<b>Commercial loans</b>						
Government	160,518	4,005	164,523	64,534	4,050	68,584
Commercial and industrial	136,850	281,110	417,960	121,947	190,002	311,949
Commercial overdrafts	65,992	13,313	79,305	58,973	22,929	81,902
Total commercial loans	363,360	298,428	661,788	245,454	216,981	462,435
Less specific allowance for credit losses on commercial loans	(240)	(1,418)	(1,658)	(166)	(1,250)	(1,416)
<b>Total commercial loans after specific allowance for credit losses</b>	<b>363,120</b>	<b>297,010</b>	<b>660,130</b>	<b>245,288</b>	<b>215,731</b>	<b>461,019</b>
<b>Commercial real estate loans</b>						
Commercial mortgage	516,861	240,876	757,737	495,466	281,456	776,922
Construction	-	2,225	2,225	109	2,119	2,228
Total commercial real estate loans	516,861	243,101	759,962	495,575	283,575	779,150
Less specific allowance for credit losses on commercial real estate loans	(964)	(5,209)	(6,173)	(8,772)	(4,711)	(13,483)
<b>Total commercial real estate loans after specific allowance for credit losses</b>	<b>515,897</b>	<b>237,892</b>	<b>753,789</b>	<b>486,803</b>	<b>278,864</b>	<b>765,667</b>
<b>Consumer loans</b>						
Automobile financing	17,647	6,640	24,287	19,663	6,050	25,713
Credit card	56,478	14,628	71,106	58,500	15,446	73,946
Overdrafts	10,021	4,044	14,065	8,488	3,933	12,421
Other consumer	55,828	89,355	145,183	66,044	94,819	160,863
Total consumer loans	139,974	114,667	254,641	152,695	120,248	272,943
Less specific allowance for credit losses on consumer loans	(160)	-	(160)	(160)	-	(160)
<b>Total consumer loans after specific allowance for credit losses</b>	<b>139,814</b>	<b>114,667</b>	<b>254,481</b>	<b>152,535</b>	<b>120,248</b>	<b>272,783</b>
<b>Residential mortgage loans</b>	<b>1,332,955</b>	<b>1,147,834</b>	<b>2,480,789</b>	<b>1,351,680</b>	<b>1,145,709</b>	<b>2,497,389</b>
Less specific allowance for credit losses on residential mortgage loans	(11,362)	(3,640)	(15,002)	(7,743)	(3,930)	(11,673)
<b>Total residential mortgage loans after specific allowance for credit losses</b>	<b>1,321,593</b>	<b>1,144,194</b>	<b>2,465,787</b>	<b>1,343,937</b>	<b>1,141,779</b>	<b>2,485,716</b>
<b>Total gross loans</b>	<b>2,353,150</b>	<b>1,804,030</b>	<b>4,157,180</b>	<b>2,245,404</b>	<b>1,766,513</b>	<b>4,011,917</b>
Less specific allowance for credit losses	(12,726)	(10,267)	(22,993)	(16,841)	(9,891)	(26,732)
Less general allowance for credit losses	(22,356)	(8,472)	(30,828)	(20,817)	(8,408)	(29,225)
<b>Net loans</b>	<b>2,318,068</b>	<b>1,785,291</b>	<b>4,103,359</b>	<b>2,207,746</b>	<b>1,748,214</b>	<b>3,955,960</b>

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 6: Loans (continued)

#### Age analysis of past due loans (including non accrual loans)

The following table summarises the past due status of the loans at 30 June 2013 and 31 December 2012. The aging of past due amounts are determined based on the contractual delinquency status of payments under the loan and this aging may be affected by the timing of the last business day at period end. An account is generally considered to be contractually delinquent when payments have not been made in accordance with the loan terms.

	30 June 2013				Total Current <sup>(1)</sup>	Total loans
	30 – 59 days	60 – 89 days	90 days or more	Total past due loans		
<b>Commercial loans</b>						
Government	-	-	-	-	164,523	164,523
Commercial and industrial	508	4	2,107	2,619	415,341	417,960
Commercial overdrafts	-	4	149	153	79,152	79,305
<b>Total commercial loans</b>	<b>508</b>	<b>8</b>	<b>2,256</b>	<b>2,772</b>	<b>659,016</b>	<b>661,788</b>
<b>Commercial real estate loans</b>						
Commercial mortgage	9,739	7,392	45,406	62,537	695,200	757,737
Construction	-	-	-	-	2,225	2,225
<b>Total commercial real estate loans</b>	<b>9,739</b>	<b>7,392</b>	<b>45,406</b>	<b>62,537</b>	<b>697,425</b>	<b>759,962</b>
<b>Consumer loans</b>						
Automobile financing	396	67	387	850	23,437	24,287
Credit card	611	205	387	1,203	69,903	71,106
Overdrafts	9	-	385	394	13,671	14,065
Other consumer	816	198	1,696	2,710	142,473	145,183
<b>Total consumer loans</b>	<b>1,832</b>	<b>470</b>	<b>2,855</b>	<b>5,157</b>	<b>249,484</b>	<b>254,641</b>
<b>Residential mortgage loans</b>	<b>24,776</b>	<b>6,168</b>	<b>61,700</b>	<b>92,644</b>	<b>2,388,145</b>	<b>2,480,789</b>
<b>Total loans</b>	<b>36,855</b>	<b>14,038</b>	<b>112,217</b>	<b>163,110</b>	<b>3,994,070</b>	<b>4,157,180</b>

<sup>(1)</sup> Loans less than 30 days past due are included in Current.

	31 December 2012				Total Current <sup>(1)</sup>	Total loans
	30 – 59 days	60 – 89 days	90 days or more	Total past due loans		
<b>Commercial loans</b>						
Government	-	-	-	-	68,584	68,584
Commercial and industrial	349	2,048	3,022	5,419	306,530	311,949
Commercial overdrafts	17	199	301	517	81,385	81,902
<b>Total commercial loans</b>	<b>366</b>	<b>2,247</b>	<b>3,323</b>	<b>5,936</b>	<b>456,499</b>	<b>462,435</b>
<b>Commercial real estate loans</b>						
Commercial mortgage	3,852	1,190	55,584	60,626	716,296	776,922
Construction	-	-	-	-	2,228	2,228
<b>Total commercial real estate loans</b>	<b>3,852</b>	<b>1,190</b>	<b>55,584</b>	<b>60,626</b>	<b>718,524</b>	<b>779,150</b>
<b>Consumer loans</b>						
Automobile financing	466	96	425	987	24,726	25,713
Credit card	623	445	601	1,669	72,277	73,946
Overdrafts	3	37	227	267	12,154	12,421
Other consumer	1,091	693	1,595	3,379	157,484	160,863
<b>Total consumer loans</b>	<b>2,183</b>	<b>1,271</b>	<b>2,848</b>	<b>6,302</b>	<b>266,641</b>	<b>272,943</b>
<b>Residential mortgage loans</b>	<b>38,334</b>	<b>21,914</b>	<b>69,551</b>	<b>129,799</b>	<b>2,367,590</b>	<b>2,497,389</b>
<b>Total loans</b>	<b>44,735</b>	<b>26,622</b>	<b>131,306</b>	<b>202,663</b>	<b>3,809,254</b>	<b>4,011,917</b>

<sup>(1)</sup> Loans less than 30 days past due are included in Current.

**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 6: Loans (continued)**

Non-accrual loans and accruing loans 90 days or more past due are summarised in the following table:

	30 June 2013			31 December 2012		
	Non-accrual loans	Accruing loans past due 90 days	Total non-performing loans	Non-accrual loans	Accruing loans past due 90 days	Total non-performing loans
<b>Commercial loans</b>						
Commercial and industrial	2,313	-	2,313	3,606	-	3,606
Commercial overdrafts	298	5	303	292	9	301
<b>Total commercial loans</b>	<b>2,611</b>	<b>5</b>	<b>2,616</b>	<b>3,898</b>	<b>9</b>	<b>3,907</b>
<b>Commercial real estate loans</b>	<b>45,406</b>	<b>-</b>	<b>45,406</b>	<b>55,167</b>	<b>417</b>	<b>55,584</b>
<b>Consumer loans</b>						
Automobile financing	566	-	566	581	57	638
Credit cards	-	387	387	-	600	600
Overdrafts	272	113	385	217	10	227
Other consumer	1,181	605	1,786	1,984	76	2,060
<b>Total consumer loans</b>	<b>2,019</b>	<b>1,105</b>	<b>3,124</b>	<b>2,782</b>	<b>743</b>	<b>3,525</b>
<b>Residential mortgage loans</b>	<b>59,976</b>	<b>21,714</b>	<b>81,690</b>	<b>51,506</b>	<b>27,229</b>	<b>78,735</b>
<b>Total loans</b>	<b>110,012</b>	<b>22,824</b>	<b>132,836</b>	<b>113,353</b>	<b>28,398</b>	<b>141,751</b>

The table below presents information about the credit quality of the Bank's loan portfolio:

	30 June 2013	Pass	Special mention	Substandard	Non-accrual	Total gross recorded investments
<b>Commercial loans</b>						
Government		164,523	-	-	-	164,523
Commercial and industrial		409,678	4,903	1,066	2,313	417,960
Commercial overdrafts		78,360	647	-	298	79,305
<b>Total commercial loans</b>		<b>652,561</b>	<b>5,550</b>	<b>1,066</b>	<b>2,611</b>	<b>661,788</b>
<b>Commercial real estate loans</b>						
Commercial mortgage		571,189	106,541	34,601	45,406	757,737
Construction		623	-	1,602	-	2,225
<b>Total commercial real estate loans</b>		<b>571,812</b>	<b>106,541</b>	<b>36,203</b>	<b>45,406</b>	<b>759,962</b>
<b>Consumer loans</b>						
Automobile financing		22,394	1,266	61	566	24,287
Credit cards		70,691	-	415	-	71,106
Overdrafts		13,570	32	191	272	14,065
Other consumer		139,623	2,839	1,540	1,181	145,183
<b>Total consumer loans</b>		<b>246,278</b>	<b>4,137</b>	<b>2,207</b>	<b>2,019</b>	<b>254,641</b>
<b>Residential mortgage loans</b>		<b>2,291,492</b>	<b>59,080</b>	<b>70,241</b>	<b>59,976</b>	<b>2,480,789</b>
<b>Total loans</b>		<b>3,762,143</b>	<b>175,308</b>	<b>109,717</b>	<b>110,012</b>	<b>4,157,180</b>

**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 6: Loans (continued)**

31 December 2012	Pass	Special mention	Substandard	Non-accrual	Total gross recorded investments
Commercial loans					
Government	68,584	-	-	-	68,584
Commercial and industrial	301,747	6,078	518	3,606	311,949
Commercial overdrafts	72,669	8,742	199	292	81,902
Total commercial loans	443,000	14,820	717	3,898	462,435
Commercial real estate loans					
Commercial mortgage	562,042	118,203	41,510	55,167	776,922
Construction	493	1,735	-	-	2,228
Total commercial real estate loans	562,535	119,938	41,510	55,167	779,150
Consumer loans					
Automobile financing	23,765	1,183	184	581	25,713
Credit cards	73,352	-	594	-	73,946
Overdrafts	11,945	186	73	217	12,421
Other consumer	154,966	3,218	695	1,984	160,863
Total consumer loans	264,028	4,587	1,546	2,782	272,943
Residential mortgage loans	2,309,945	68,531	67,407	51,506	2,497,389
Total loans	3,579,508	207,876	111,180	113,353	4,011,917

The four credit quality classifications set out above are defined below and describe the credit quality of the Group's lending portfolio. These classifications each encompass a range of more granular, internal credit rating grades assigned.

**Quality classification definitions**

**Pass:**

A pass loan shall mean a loan that is expected to be repaid as agreed. A loan is classified as pass where the Bank is not expected to face repayment difficulties because the present and projected cash flows are sufficient to repay the debt and the repayment schedule as established by the agreement is being followed.

**Special mention:**

A special mention loan shall mean a loan under close monitoring by the Bank's Management. Loans in this category are currently protected and still performing (current with respect to interest and principal payments), but are potentially weak and present an undue credit risk exposure, but not to the point of justifying a classification of Substandard.

**Substandard:**

A substandard loan shall mean a loan whose evident unreliability makes repayment doubtful and there is a threat of loss to the Bank unless the unreliability is averted.

**Non-accrual:**

Either where Management is of the opinion full payment of principal or interest is in doubt or when principal or interest is 90 days past due and for residential loans which are not well secured and in the process of collection.

The table below presents the impairment methodology applied to the Bank's loan portfolio:

	30 June 2013		31 December 2012	
	Individually evaluated	Collectively evaluated	Individually evaluated	Collectively evaluated
<b>Total gross loans evaluated for impairment</b>				
Commercial loans	661,788	-	462,435	-
Commercial real estate loans	759,962	-	779,150	-
Consumer loans	2,019	252,622	2,782	270,161
Residential mortgage loans	109,422	2,371,367	59,910	2,437,479
<b>Total gross loans</b>	<b>1,533,191</b>	<b>2,623,989</b>	<b>1,304,277</b>	<b>2,707,640</b>



**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 6: Loans (continued)**

The table below presents the changes in the allowance for credit loan losses:

	30 June 2013					31 December 2012				
	Commercial	Commercial real estate	Consumer	Residential mortgage	Total	Commercial	Commercial real estate	Consumer	Residential mortgage	Total
<b>Allowances at beginning of year</b>	6,596	18,394	5,440	25,527	55,957	8,336	17,888	5,735	23,532	55,491
Provision taken during the year	995	3,310	(1,221)	4,749	7,833	(860)	7,541	1,327	6,182	14,190
Recoveries	1,556	-	1,818	-	3,374	490	-	2,953	303	3,746
Charge-offs	(28)	(10,306)	(1,587)	(929)	(12,850)	(1,490)	(6,630)	(4,678)	(4,972)	(17,770)
Other	(38)	(189)	(47)	(219)	(493)	120	(405)	103	482	300
<b>Allowances at end of year</b>	<b>9,081</b>	<b>11,209</b>	<b>4,403</b>	<b>29,128</b>	<b>53,821</b>	<b>6,596</b>	<b>18,394</b>	<b>5,440</b>	<b>25,527</b>	<b>55,957</b>

Ending balance: individually evaluated for impairment	1,658	6,173	160	15,002	22,993	1,416	13,483	160	11,673	26,732
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Ending balance: collectively evaluated for impairment	7,423	5,036	4,243	14,126	30,828	5,180	4,911	5,280	13,854	29,225
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A loan is considered to be impaired when, based on current information and events, the Bank determines that it will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Impaired loans include all non-accrual loans and all loans modified in a TDR even if full collectability is expected following the restructuring. For the period ended 30 June 2013, the amount of gross interest income would have been recorded had impaired loans been current was \$3.5 million (30 June 2012: \$3.5 million). The table below present information about the Bank's impaired loans:

30 June 2013	Impaired loans with an allowance			Impaired loans without an allowance	Total impaired loans		
	Gross recorded investments	Specific allowance	Net loans	Gross recorded investments	Gross recorded investments	Specific allowance	Net loans
<b>Commercial loans</b>							
Commercial and industrial	1,601	(1,558)	43	2,419	4,020	(1,558)	2,462
Commercial overdrafts	155	(100)	55	144	299	(100)	199
<b>Total commercial loans</b>	<b>1,756</b>	<b>(1,658)</b>	<b>98</b>	<b>2,563</b>	<b>4,319</b>	<b>(1,658)</b>	<b>2,661</b>
<b>Commercial real estate loans</b>	<b>10,629</b>	<b>(6,173)</b>	<b>4,456</b>	<b>44,631</b>	<b>55,260</b>	<b>(6,173)</b>	<b>49,087</b>
<b>Consumer loans</b>							
Automobile financing	217	(75)	142	349	566	(75)	491
Overdrafts	-	-	-	272	272	-	272
Other consumer	128	(85)	43	1,053	1,181	(85)	1,096
<b>Total consumer loans</b>	<b>345</b>	<b>(160)</b>	<b>185</b>	<b>1,674</b>	<b>2,019</b>	<b>(160)</b>	<b>1,859</b>
<b>Residential mortgage loans</b>	<b>50,404</b>	<b>(15,002)</b>	<b>35,402</b>	<b>19,123</b>	<b>69,527</b>	<b>(15,002)</b>	<b>54,525</b>
<b>Total impaired loans</b>	<b>63,134</b>	<b>(22,993)</b>	<b>40,141</b>	<b>67,991</b>	<b>131,125</b>	<b>(22,993)</b>	<b>108,132</b>

31 December 2012	Impaired loans with an allowance			Impaired loans without an allowance	Total impaired loans		
	Gross recorded investments	Specific allowance	Net loans	Gross recorded investments	Gross recorded investments	Specific allowance	Net loans
<b>Commercial loans</b>							
Commercial and industrial	1,471	(1,390)	81	3,846	5,317	(1,390)	3,927
Commercial overdrafts	26	(26)	-	266	292	(26)	266
<b>Total commercial loans</b>	<b>1,497</b>	<b>(1,416)</b>	<b>81</b>	<b>4,112</b>	<b>5,609</b>	<b>(1,416)</b>	<b>4,193</b>
<b>Commercial real estate loans</b>	<b>52,607</b>	<b>(13,483)</b>	<b>39,124</b>	<b>12,132</b>	<b>64,739</b>	<b>(13,483)</b>	<b>51,256</b>
<b>Consumer loans</b>							
Automobile financing	227	(75)	152	354	581	(75)	506
Overdrafts	-	-	-	217	217	-	217
Other consumer	128	(85)	43	1,856	1,984	(85)	1,899
<b>Total consumer loans</b>	<b>355</b>	<b>(160)</b>	<b>195</b>	<b>2,427</b>	<b>2,782</b>	<b>(160)</b>	<b>2,622</b>
<b>Residential mortgage loans</b>	<b>36,064</b>	<b>(11,673)</b>	<b>24,391</b>	<b>23,846</b>	<b>59,910</b>	<b>(11,673)</b>	<b>48,237</b>
<b>Total impaired loans</b>	<b>90,523</b>	<b>(26,732)</b>	<b>63,791</b>	<b>42,517</b>	<b>133,040</b>	<b>(26,732)</b>	<b>106,308</b>

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 6: Loans (continued)

The following table presents information about the Bank's average impaired loan balances and interest income recognised for the period ended 30 June 2013 on the impaired loans:

30 June 2013	Impaired loans	
	Average recorded investment	Interest income recognised
<b>Commercial loans</b>		
Commercial and industrial	4,669	49
Commercial overdrafts	296	-
<b>Total commercial loans</b>	<b>4,965</b>	<b>49</b>
<b>Commercial real estate loans</b>	<b>60,000</b>	<b>268</b>
<b>Consumer loans</b>		
Automobile financing	573	-
Credit cards	-	-
Overdrafts	245	-
Other consumer	1,583	-
<b>Total consumer loans</b>	<b>2,401</b>	<b>-</b>
<b>Residential mortgage loans</b>	<b>64,719</b>	<b>336</b>
<b>Total impaired loans</b>	<b>132,085</b>	<b>653</b>

The table presents information about the Bank's loans modified in a troubled debt restructuring:

30 June 2013					Effect of modification on recorded investment	
	Number of contracts	Recorded investment	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Changes in the timing of principal or interest payments	Interest capitalisation
Commercial loans						
Commercial and industrial	3	1,707	1,907	1,907	-	-
Total commercial loans	3	1,707	1,907	1,907	-	-
Commercial real estate loans	7	18,486	24,785	24,882	-	97
Residential mortgage loans	21	13,286	12,502	13,311	-	809
Total loans	31	33,479	39,194	40,100	-	906

<sup>(1)</sup> The amount is comprised of \$12.4 million of non-accrual loans and \$21.1 million of loans on accrual status.

31 December 2012						Effect of modification on recorded investment	
	Number of contracts	Recorded investment	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Changes in the timing of principal or interest payments	Interest capitalisation	
Commercial loans							
Commercial and industrial	3	2,083	2,290	2,326	-	36	
Total commercial loans	3	2,083	2,290	2,326	-	36	
Commercial real estate loans	7	22,854	24,402	24,463	-	61	
Residential mortgage loans	15	10,977	9,185	9,926	-	741	
Total loans	25	35,914 <sup>(1)</sup>	35,877	36,715	-	838	

<sup>(1)</sup> The amount is comprised of \$16.2 million of non-accrual loans and \$19.7 million of loans on accrual status.

The Bank has 3 loans modified in a TDR from 1 July 2012 to 30 June 2013 that subsequently defaulted (i.e., 90 days or more past due following a modification) with a recorded investment amounting to \$2.5 million.

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 7: Credit Risk Concentrations

Concentrations of credit risk in the lending and off-Balance Sheet credit-related arrangements portfolios arise when a number of customers are engaged in similar business activities, are in the same geographic region, or when they have similar economic features that would cause their ability to meet contractual obligations to be similarly affected by changes in economic conditions. The Bank regularly monitors various segments of its credit risk portfolio to assess potential concentrations of risks and to obtain collateral when deemed necessary. In the Bank's commercial portfolio, risk concentrations are primarily evaluated by industry and by geographic region of loan origination. In the consumer portfolio, concentrations are primarily evaluated by products. Credit exposures include loans, guarantees and acceptances, letters of credit and commitments for undrawn lines of credit. Unconditionally cancellable credit cards and overdrafts lines of credit are excluded from the tables below.

The following table summarises the credit exposure of the Bank by business sector. The on-Balance Sheet exposure amounts disclosed are net of specific allowances and the off-Balance Sheet exposure amounts disclosed is gross of collateral held.

	30 June 2013			31 December 2012		
	On-balance sheet	Off-balance sheet	Total credit exposure	On-balance sheet	Off-balance sheet	Total credit exposure
Banks and financial services	345,894	373,791	719,685	277,273	394,858	672,131
Commercial and merchandising	289,922	130,747	420,669	263,723	88,551	352,274
Governments	155,147	18,194	173,341	58,811	28,153	86,964
Individuals	2,316,607	136,452	2,453,059	2,334,272	94,430	2,428,702
Primary industry and manufacturing	58,305	-	58,305	65,608	6,161	71,769
Real estate	875,843	33,495	909,338	887,178	36,523	923,701
Hospitality industry	85,213	-	85,213	90,978	-	90,978
Transport and communication	7,256	-	7,256	7,342	-	7,342
Sub-total	4,134,187	692,679	4,826,866	3,985,185	648,676	4,633,861
General allowance	(30,828)	-	(30,828)	(29,225)	-	(29,225)
<b>Total</b>	<b>4,103,359</b>	<b>692,679</b>	<b>4,796,038</b>	<b>3,955,960</b>	<b>648,676</b>	<b>4,604,636</b>

The following table summarises the credit exposure of the Bank by geographic region of loan origination:

	30 June 2013			31 December 2012		
	On-balance sheet	Off-balance sheet	Total credit exposure	On-balance sheet	Off-balance sheet	Total credit exposure
Bermuda	2,490,034	345,115	2,835,149	2,300,661	335,184	2,635,845
Cayman	565,327	186,658	751,985	547,779	194,634	742,413
Guernsey	516,888	80,663	597,551	534,226	72,961	607,187
The Bahamas	45,192	360	45,552	47,883	180	48,063
United Kingdom	516,746	79,883	596,629	554,636	45,717	600,353
Sub-total	4,134,187	692,679	4,826,866	3,985,185	648,676	4,633,861
General allowance	(30,828)	-	(30,828)	(29,225)	-	(29,225)
<b>Total</b>	<b>4,103,359</b>	<b>692,679</b>	<b>4,796,038</b>	<b>3,955,960</b>	<b>648,676</b>	<b>4,604,636</b>

**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 8: Customer Deposits and Deposits from Banks**

**a) By Maturity**

	30 June 2013			31 December 2012		
	Customers	Banks	Total	Customers	Banks	Total
<b>Demand deposits</b>						
Demand deposits - Non-interest bearing	944,489	245	944,734	918,814	567	919,381
Demand deposits - Interest bearing	4,901,209	42,334	4,943,543	4,405,291	99,573	4,504,864
<b>Sub-total - demand deposits</b>	<b>5,845,698</b>	<b>42,579</b>	<b>5,888,277</b>	<b>5,324,105</b>	<b>100,140</b>	<b>5,424,245</b>
<b>Term deposits</b>						
Term deposits maturing within six months	1,528,793	27,222	1,556,015	1,763,515	15,965	1,779,480
Term deposits maturing between six to twelve months	129,094	199	129,293	98,051	10,240	108,291
Term deposits maturing after twelve months	76,266	121	76,387	81,101	121	81,222
<b>Sub-total - term deposits</b>	<b>1,734,153</b>	<b>27,542</b>	<b>1,761,695</b>	<b>1,942,667</b>	<b>26,326</b>	<b>1,968,993</b>
<b>Total</b>	<b>7,579,851</b>	<b>70,121</b>	<b>7,649,972</b>	<b>7,266,772</b>	<b>126,466</b>	<b>7,393,238</b>

**b) By Type and Location**

	30 June 2013			31 December 2012		
	Payable on demand	Payable on a fixed date	Total	Payable on demand	Payable on a fixed date	Total
<b>Bermuda</b>						
Customers	2,560,838	795,129	3,355,967	2,364,433	890,886	3,255,319
Banks	31,438	903	32,341	88,169	249	88,418
<b>Cayman</b>						
Customers	1,594,117	426,383	2,020,500	1,468,025	394,159	1,862,184
Banks	8,883	26,639	35,522	10,643	26,077	36,720
<b>Guernsey</b>						
Customers	1,278,032	196,768	1,474,800	1,073,711	296,255	1,369,966
Banks	2,167	-	2,167	1,281	-	1,281
<b>The Bahamas</b>						
Customers	89,233	5,999	95,232	65,587	4,413	70,000
<b>United Kingdom</b>						
Customers	323,478	309,874	633,352	352,349	356,954	709,303
Banks	91	-	91	47	-	47
<b>Total Customers</b>	<b>5,845,698</b>	<b>1,734,153</b>	<b>7,579,851</b>	<b>5,324,105</b>	<b>1,942,667</b>	<b>7,266,772</b>
<b>Total Banks</b>	<b>42,579</b>	<b>27,542</b>	<b>70,121</b>	<b>100,140</b>	<b>26,326</b>	<b>126,466</b>
<b>Total</b>	<b>5,888,277</b>	<b>1,761,695</b>	<b>7,649,972</b>	<b>5,424,245</b>	<b>1,968,993</b>	<b>7,393,238</b>

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 9: Employee Future Benefits

The Bank maintains trustee pension plans including non-contributory defined benefit plans and a number of defined contribution plans, and provides post-retirement medical benefits to its qualifying retirees. The defined benefit provisions under the pension plans are generally based upon years of service and average salary during the final years of employment. The defined benefit and post-retirement medical plans are not open to new participants and are non-contributory and the funding required is provided by the Bank, based upon the advice of an independent actuary.

The following table presents the expense constituents of the Bank's defined benefit pension plans and the Bank's post-retirement medical benefit plan:

	For the three month period ended		For the six month period ended	
	30 June 2013	30 June 2012	30 June 2013	30 June 2012
<b>Defined benefit pension expense</b>				
Service cost	379	428	761	871
Interest cost	1,687	1,735	3,380	3,498
Expected return on plan assets	(2,266)	(2,023)	(4,538)	(4,077)
Amortisation of net actuarial loss	386	328	772	658
<b>Total defined benefit pension expense</b>	<b>186</b>	<b>468</b>	<b>375</b>	<b>950</b>
<b>Post-retirement medical benefit expense</b>				
Service cost	260	236	521	472
Interest cost	1,064	1,052	2,127	2,103
Amortisation of net actuarial loss	607	518	1,213	1,037
Amortisation of past service cost	(1,680)	(1,680)	(3,360)	(3,360)
<b>Total post-retirement medical benefits expense</b>	<b>251</b>	<b>126</b>	<b>501</b>	<b>252</b>

The net actuarial loss of the Bermuda Defined Benefit pension plan is amortised to net income over the estimated average remaining lifetime of all members of 22 years. The net actuarial loss of the Bermuda Post-Retirement medical plan is amortised to net income over the estimated average remaining service period for active members of 7.2 years and the past service costs are amortised to net income over the expected average remaining service period to full eligibility of active members expected to receive benefits under the plan (4.1 years for 2010 plan and 5.6 years for 2011 plan amendments). The Plans are subject to an annual actuarial review as at 31 December each year with the latest valuation performed as at 31 December 2012.

### Note 10: Credit-Related Arrangements and Commitments

The Bank considers the fees collected in connection with the issuance of standby letters of credit and letters of guarantee to be representative of the fair value of its obligation undertaken in issuing the guarantee. In accordance with applicable accounting standards related to guarantees, the Bank defers fees collected in connection with the issuance of standby letters of credit and letters of guarantee. The fees are then recognised in income proportionately over the life of the credit agreements.

The following table presents the outstanding financial guarantees with contractual amounts representing credit risk as follows:

	30 June 2013			31 December 2012		
	Gross	Collateral	Net	Gross	Collateral	Net
Standby letters of credit	281,992	279,823	2,169	280,089	277,259	2,830
Letters of guarantee	10,606	8,601	2,005	11,207	8,694	2,513
<b>Total</b>	<b>292,598</b>	<b>288,424</b>	<b>4,174</b>	<b>291,296</b>	<b>285,953</b>	<b>5,343</b>

Collateral is shown at estimated market value less selling cost. Where cash is the collateral, this is shown gross including interest income.

The Bank enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Bank's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for possible loan losses.

The following table presents the unfunded legally binding commitments to extend credit with contractual amounts representing credit risk as follows:

	30 June 2013	31 December 2012
Commitments to extend credit	397,833	356,122
Documentary and commercial letters of credit	2,248	1,258
<b>Total</b>	<b>400,081</b>	<b>357,380</b>

The Bank has a facility by one of its custodians, whereby the Bank may offer up to US\$200 million of standby letters of credit to its customers on a fully secured basis. Under the standard terms of the facility, the custodian has the right to set-off against securities held of 110% of the utilised facility. At 30 June 2013, \$132.9 million (2012: \$137.0 million) of standby letters of credit were issued under this facility.

## The Bank of N.T. Butterfield & Son Limited

### Notes to the Unaudited Consolidated Financial Statements *(continued)*

*(In thousands of Bermuda dollars)*

#### Note 10: Credit-Related Arrangements and Commitments *(continued)*

##### Legal Proceedings

There are a number of actions and legal proceedings pending against the Bank and its subsidiaries which arose in the normal course of its business. Management, after reviewing all actions and proceedings, pending against or involving the Bank and its subsidiaries, considers that the resolution of these matters would not be material to the consolidated financial position of the Bank.

#### Note 11: Segmented Information

At 30 June 2013, for Management reporting purposes, the operations of the Bank are grouped into the following six business segments based upon the geographic location of the Bank's operations: Bermuda, Cayman, Guernsey, Switzerland, The Bahamas and United Kingdom. Accounting policies of the reportable segments are the same as those described in Note 2 in Bank's audited financial statements for the year ending 31 December 2012.

Bermuda provides a full range of retail, commercial and private banking services. Retail services are offered to individuals and small to medium-sized businesses through five branch locations and through telephone banking, Internet banking, automated teller machines ("ATMs") and debit cards. Retail services include deposit services, consumer and mortgage lending, credit cards and personal insurance products. Commercial banking includes commercial lending and mortgages, cash management, payroll services, remote banking and letters of credit. Treasury services include money market and foreign exchange activities. Bermuda's wealth management offering consists of Butterfield Asset Management Limited, which provides investment management, advisory and brokerage services and Butterfield Trust (Bermuda) Limited, which provides trust, estate, company management and custody services.

The Cayman segment provides a comprehensive range of retail, commercial and private banking services. Retail services are offered to individuals and small to medium-sized businesses through three branch locations and through Internet banking, automated teller machines ("ATMs") and debit cards. Retail services include deposit services, consumer and mortgage lending, credit cards and property/auto insurance. Commercial banking includes commercial lending and mortgages, cash management, payroll services, remote banking and letters of credit. Treasury services include money market and foreign exchange activities. Cayman's wealth management offering comprise investment management, advisory and brokerage services and Butterfield Trust (Cayman) Limited, which provides trust, estate and company management.

The Guernsey segment provides a broad range of services to private clients and financial institutions including private banking and treasury services, Internet banking, administered bank services, wealth management and fiduciary services.

The Switzerland segment provides fiduciary services.

The Bahamas segment provides fiduciary and ancillary services.

The United Kingdom segment provides a broad range of services including private banking and treasury services, Internet banking and wealth management and fiduciary services to high net worth individuals and privately owned businesses.

The Barbados segment was sold on 27 August 2012 as disclosed in Note 2: Discontinued operations.

##### Total Assets by Segment

	30 June 2013	31 December 2012
Bermuda	4,640,890	4,624,036
Cayman	2,321,495	2,116,520
Guernsey	1,606,825	1,522,429
Switzerland	1,383	1,521
The Bahamas	108,962	82,712
United Kingdom	838,865	925,389
Total assets	9,518,420	9,272,607
Less: inter-segment eliminations	(521,761)	(439,598)
<b>Total</b>	<b>8,996,659</b>	<b>8,833,009</b>

**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 11: Segmented Information (continued)**

For the three month period  
ended 30 June 2013

	Net interest income								
	Customer	Inter-segment	Provision for credit losses	Non-interest income	Revenue before gains and losses	Total expense	Net income (loss) before gains and losses	Gains and losses	Net income (loss)
Bermuda	34,013	391	(2,300)	14,867	46,971	35,846	11,125	12,839	23,964
Cayman	12,036	278	(627)	8,051	19,738	12,832	6,906	(412)	6,494
Guernsey	4,820	1	38	4,778	9,637	7,682	1,955	-	1,955
Switzerland	-	-	-	400	400	585	(185)	-	(185)
The Bahamas	17	24	58	1,496	1,595	1,354	241	-	241
United Kingdom	4,185	(694)	(367)	1,733	4,857	4,415	442	12	454
<b>Total before eliminations</b>	<b>55,071</b>	<b>-</b>	<b>(3,198)</b>	<b>31,325</b>	<b>83,198</b>	<b>62,714</b>	<b>20,484</b>	<b>12,439</b>	<b>32,923</b>
Add / (Less): inter-segment eliminations / transactions	-	-	-	(310)	(310)	(310)	-	-	-
<b>Total from continuing operations</b>	<b>55,071</b>	<b>-</b>	<b>(3,198)</b>	<b>31,015</b>	<b>82,888</b>	<b>62,404</b>	<b>20,484</b>	<b>12,439</b>	<b>32,923</b>

For the three month period  
ended 30 June 2012

	Net interest income								
	Customer	Inter-segment	Provision for credit losses	Non-interest income	Revenue before gains and losses	Total expense	Net income (loss) before gains and losses	Gains and losses	Net income (loss)
Bermuda	33,207	352	64	16,345	49,968	40,950	9,018	(529)	8,489
Cayman	11,149	298	(1,191)	7,604	17,860	13,782	4,078	4,251	8,329
Guernsey	5,326	(38)	(33)	5,021	10,276	7,580	2,696	(31)	2,665
Switzerland	-	-	-	263	263	620	(357)	-	(357)
The Bahamas	52	99	-	1,159	1,310	1,289	21	-	21
United Kingdom	4,245	(711)	(3,781)	2,543	2,296	4,636	(2,340)	(767)	(3,107)
<b>Total before eliminations</b>	<b>53,979</b>	<b>-</b>	<b>(4,941)</b>	<b>32,935</b>	<b>81,973</b>	<b>68,857</b>	<b>13,116</b>	<b>2,924</b>	<b>16,040</b>
Add / (Less): inter-segment eliminations / transactions	-	-	-	(482)	(482)	(482)	-	-	-
<b>Total from continuing operations</b>	<b>53,979</b>	<b>-</b>	<b>(4,941)</b>	<b>32,453</b>	<b>81,491</b>	<b>68,375</b>	<b>13,116</b>	<b>2,924</b>	<b>16,040</b>

For the six month period  
ended 30 June 2013

	Net interest income								
	Customer	Inter-segment	Provision for credit losses	Non-interest income	Revenue before gains and losses	Total expense	Net income (loss) before gains and losses	Gains and losses	Net income (loss)
Bermuda	65,772	754	(6,644)	29,179	89,061	73,296	15,765	13,291	29,056
Cayman	23,747	572	(851)	15,885	39,353	27,243	12,110	(897)	11,213
Guernsey	9,740	2	(29)	9,611	19,324	15,214	4,110	-	4,110
Switzerland	-	-	-	788	788	1,176	(388)	-	(388)
The Bahamas	35	53	58	2,918	3,064	2,562	502	-	502
United Kingdom	7,951	(1,381)	(367)	3,344	9,547	8,477	1,070	162	1,232
<b>Total before eliminations</b>	<b>107,245</b>	<b>-</b>	<b>(7,833)</b>	<b>61,725</b>	<b>161,137</b>	<b>127,968</b>	<b>33,169</b>	<b>12,556</b>	<b>45,725</b>
Add / (Less): inter-segment eliminations / transactions	-	-	-	(845)	(845)	(845)	-	485	485
<b>Total from continuing operations</b>	<b>107,245</b>	<b>-</b>	<b>(7,833)</b>	<b>60,880</b>	<b>160,292</b>	<b>127,123</b>	<b>33,169</b>	<b>13,041</b>	<b>46,210</b>

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 11: Segmented Information (continued)

For the six month period ended  
30 June 2012

	Net interest income								
	Customer	Inter-segment	Provision for credit losses	Non-interest income	Revenue before gains and losses	Total expense	Net income (loss) before gains and losses	Gains and losses	Net income (loss)
Bermuda	66,041	648	(3,207)	32,113	95,595	83,048	12,547	1,791	14,338
Cayman	21,565	608	(1,341)	16,133	36,965	27,251	9,714	4,489	14,203
Guernsey	11,035	(35)	(351)	10,189	20,838	15,686	5,152	(31)	5,121
Switzerland	-	-	-	554	554	1,180	(626)	-	(626)
The Bahamas	94	210	-	2,335	2,639	2,755	(116)	-	(116)
United Kingdom	8,426	(1,431)	(3,480)	4,930	8,445	9,966	(1,521)	(796)	(2,317)
Total before eliminations	107,161	-	(8,379)	66,254	165,036	139,886	25,150	5,453	30,603
Add / (Less): inter-segment eliminations / transactions	-	-	-	(1,264)	(1,264)	(1,264)	-	-	-
Total from continuing operations	107,161	-	(8,379)	64,990	163,772	138,622	25,150	5,453	30,603

### Note 12: Accounting for Derivative Instruments and Risk Management

The Bank uses derivatives in the asset and liability management ("ALM") of positions and to meet the needs of its customers with their risk management objectives. The Bank's derivative contracts principally involve over-the-counter transactions that are privately negotiated between the Bank and the counterparty to the contract and include interest rate contracts and foreign exchange contracts.

The Bank may pursue opportunities to reduce its exposure to credit losses on derivatives by entering into International Swaps and Derivatives Association Master Agreements ("ISDAs"). Depending on the nature of the derivative transaction, bilateral collateral arrangements may be used as well. When the Bank is engaged in more than one outstanding derivative transaction with the same counterparty, and also has a legally enforceable master netting agreement with that counterparty, the net marked to market exposure represents the netting of the positive and negative exposures with that counterparty. When there is a net negative exposure, the Bank regards its credit exposure to the counterparty as being zero. The net marked to market position with a particular counterparty represents a reasonable measure of credit risk when there is a legally enforceable master netting agreement between the Bank and that counterparty.

Certain of these agreements contain credit risk-related contingent features in which the counterparty has the option to accelerate cash settlement of the Bank's net derivative liabilities with the counterparty in the event the Bank's credit rating falls below specified levels or the liabilities reach certain levels.

All derivative financial instruments, whether designated as hedges or not, are recorded on the Consolidated Balance Sheet at fair value within Other assets or Other liabilities. These amounts include the effect of netting. The accounting for changes in the fair value of a derivative in the Consolidated Statement of Operations depends on whether the contract has been designated as a hedge and qualifies for hedge accounting.

#### Notional amounts

The notional amounts are not recorded as assets or liabilities on the Consolidated Balance Sheet as they represent the face amount of the contract to which a rate or price is applied to determine the amount of cash flows to be exchanged. Notional amounts represent the volume of outstanding transactions and do not represent the potential gain or loss associated with market risk or credit risk of such instruments. Credit risk is limited to the positive fair value of the derivative instrument, which is significantly less than the notional amount.

#### Fair value

Derivative instruments, in the absence of any compensating up-front cash payments, generally have no market value at inception. They obtain value, positive or negative, as relevant interest rates, exchange rates, equity or commodity prices or indices change. The potential for derivatives to increase or decrease in value as a result of the foregoing factors is generally referred to as market risk. Market risk is managed within clearly defined parameters as prescribed by Senior Management of the Bank. The fair value is defined as the profit or loss associated with replacing the derivative contracts at prevailing market prices.

#### Risk management derivatives

The Bank enters into interest derivative contracts as part of its overall interest rate risk management strategy to minimise significant unplanned fluctuations in earnings that are caused by interest rate volatility. The Bank's goal is to manage interest rate sensitivity by modifying the repricing or maturity characteristics of certain Consolidated Balance Sheet assets and liabilities so that movements in interest rates do not adversely affect the net interest margin. Derivative instruments that are used as part of the Bank's risk management strategy include interest rate swap contracts that have indices related to the pricing of specific Consolidated Balance Sheet assets and liabilities. Interest rate swaps generally involve the exchange of fixed and variable-rate interest payments between two parties, based on a common notional principal amount and maturity date.

The Bank uses foreign currency derivative instruments to hedge its exposure to foreign currency risk. Certain hedging relationships are formally designated and qualify for hedge accounting as fair value or net investment hedges.



# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 12: Accounting for Derivative Instruments and Risk Management (continued)

Risk management derivatives comprise:

#### Fair value hedges

Derivatives are designated as fair value hedges to minimise the Bank's exposure to changes in the fair value of assets and liabilities due to movements in interest rates. The Bank enters into interest rate swaps to convert its fixed-rate long-term loans to floating-rate loans, and convert fixed-rate deposits to floating-rate deposits. Changes in fair value of these derivatives are recognised in income. For fair value hedges, the Bank applies the "shortcut" method of accounting, which assumes there is no ineffectiveness in a hedge. As a result, changes recorded in the fair value of the hedged item are equal to the offsetting gain or loss on the derivative and are reflected in the same line item. During the year ended 31 December 2011, the Bank cancelled its Interest Rate Swaps designated as fair value hedges of loans receivable and therefore discontinued hedge accounting for these financial instruments. The fair value attributable to the hedged loans are accounted for prospectively and are being amortised to net income over the remaining life of each individual loan using the effective interest method.

#### Net investment hedges

Foreign currency swaps and qualifying non-derivative instruments designated as net investment hedges are used to minimize the Bank's exposure to variability in the foreign currency translation of net investments in foreign operations. The effective portion of changes in the fair value of the hedging instrument is recognized in AOCI consistent with the related translation gains and losses of the hedged net investment. For net investment hedges, all critical terms of the hedged item and the hedging instrument are matched at inception and on an ongoing basis to minimize the risk of hedge ineffectiveness.

For derivatives designated as net investment hedges, the Bank follows the forward-rate method in measuring the amount of ineffectiveness in a net investment hedge. According to that method, all changes in fair value, including changes related to the forward-rate component and the time value of currency swaps, are recorded in the foreign currency translation adjustment account within Accumulated other comprehensive income (loss). To the extent all terms are not perfectly matched, any ineffectiveness is measured using the hypothetical derivative method. Ineffectiveness resulting from net investment hedges is recorded in foreign exchange income. Amounts recorded in AOCI are reclassified to earnings only upon the sale or liquidation of an investment in a foreign subsidiary.

For foreign-currency-denominated debt instruments that are designated as hedges of net investments, the translation gain or loss that is recorded in the foreign currency translation adjustment account is based on the spot exchange rate between the functional currencies of the respective subsidiary.

#### Derivatives not formally designated as hedges

Derivatives not formally designated as hedges are entered into to manage the interest rate risk of fixed rate deposits with banks and foreign exchange risk of the Banks' exposure. Changes in the fair value of derivative instruments not formally designated as hedges are recognised in foreign exchange income.

#### Client service derivatives

The Bank enters into foreign exchange contracts and interest rate caps primarily to meet the foreign exchange needs of its customers. Foreign exchange contracts are agreements to exchange specific amounts of currencies at a future date at a specified rate of exchange. Changes in the fair value of client services derivative instruments are recognised in income.

The following table shows the aggregate notional amounts of derivative contracts outstanding listed by type and respective gross positive or negative fair values and divided by those used for risk management (sub-classified as hedging and those that do not qualify for hedge accounting), client services and credit derivatives. Fair value of derivatives is recorded in the Consolidated Balance Sheet in Other assets and Other liabilities. Gross positive fair values are recorded in Other assets and gross negative fair values are recorded in Other liabilities, subject to netting when master netting agreements are in place.

30 June 2013	Derivative Instrument	Notional amounts	Positive fair value	Negative fair value	Net fair value
<b>Risk management derivatives</b>					
Fair-value hedges					
Fixed-rate loans	Interest rate swaps	7,605	-	(12)	(12)
Net investment hedges					
	Currency swaps	47,654	794	-	794
Derivatives not formally designated as hedging instruments					
	Currency swaps	301,361	2,171	(8,304)	(6,145)
Subtotal risk management derivatives		349,015	2,965	(8,316)	(5,351)
<b>Client services derivatives</b>					
	Spot and forward foreign exchange	3,269,114	9,086	(9,272)	(186)
Subtotal client services derivatives		3,269,114	9,086	(9,272)	(186)
Total derivative instruments		3,618,129	12,051	(17,588)	(5,537)

## The Bank of N.T. Butterfield & Son Limited

### Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

#### Note 12: Accounting for Derivative Instruments and Risk Management (continued)

31 December 2012	Derivative Instrument	Notional amounts	Positive fair value	Negative fair value	Net fair value
Risk management derivatives					
Fair-value hedges					
Fixed-rate loans	Interest rate swaps	8,529	-	(89)	(89)
Net investment hedges					
	Currency swaps	42,523	-	(116)	(116)
Derivatives not formally designated as hedging instruments					
	Currency swaps	301,161	113	(10,779)	(10,666)
Subtotal risk management derivatives		352,213	113	(10,984)	(10,871)
Client services derivatives					
	Spot and forward foreign exchange	2,444,357	14,312	(13,972)	340
Subtotal client services derivatives		2,444,357	14,312	(13,972)	340
Total derivative instruments		2,796,570	14,425	(24,956)	(10,531)

In addition to the above, Foreign denominated deposits, totalling \$110.5 million at 30 June 2013 (31 December 2012: \$133.6 million), was designated as a hedge of foreign exchange risk associated with the net investment in foreign operations.

The following table shows the location and amount of gains (losses) recorded in the Consolidated Statement of Operations.

Derivative instrument	Consolidated Statement of Operations line item	For the three month period ended		For the six month period ended	
		30 June 2013	30 June 2012	30 June 2013	30 June 2012
Interest rate swaps	Net other gains (losses)	36	-	73	1
Forward foreign exchange contracts	Foreign exchange revenue	(33)	(803)	462	71
Foreign currency options	Foreign exchange revenue	-	144	-	(447)
Total net gains recognised in net income		3	(659)	535	(375)

#### Note 13: Fair Value of Financial Instruments

The following table presents the financial assets and liabilities that are measured at fair value on a recurring basis and classifies such fair value based on the type of input used in the related valuations.

Management reviews the price of each security monthly, comparing market values to expectations and to the prior month's price. Management's expectations are based upon knowledge of prevailing market conditions and developments relating to specific issuers and/or asset classes held in the investment portfolio. Where there are unusual or significant price movements, or where a certain asset class has performed out-of-line with expectations, the matter is reviewed by the Group Asset and Liability Committee.

Management classifies items that are recognised at fair value on a recurring basis based on the level of inputs used in their respective fair value determination.

Financial instruments in Level 1 include listed equity shares and actively traded redeemable mutual funds.

Financial instruments in Level 2 include equity securities not actively traded, certificates of deposit, corporate bonds, mortgage-backed securities and other asset-backed securities, interest rate swaps and caps and forward foreign exchange contracts, and mutual funds not actively traded.

Financial instruments in Level 3 include non-redeemable private equity shares, corporate bonds, mortgage-backed securities and other asset-backed securities for which the market is relatively illiquid and for which information about actual trading prices is not readily available.

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 13: Fair Value of Financial Instruments (continued)

Items that are recognised at fair value on a recurring basis

30 June 2013  
Fair value

31 December 2012  
Fair value

	Level 1	Level 2	Level 3	Total carrying amount / Fair value	Level 1	Level 2	Level 3	Total carrying amount / Fair value
<b>Financial assets</b>								
Trading								
Debt securities issued by non-US governments	-	4,650	-	4,650	-	5,231	-	5,231
Mutual funds	5,470	50,976	-	56,446	5,337	51,217	-	56,554
<b>Total Trading</b>	<b>5,470</b>	<b>55,626</b>	<b>-</b>	<b>61,096</b>	<b>5,337</b>	<b>56,448</b>	<b>-</b>	<b>61,785</b>
Available for sale								
Certificates of deposit	-	268,230	-	268,230	-	561,360	-	561,360
US government and federal agencies	-	1,392,341	-	1,392,341	-	1,178,786	-	1,178,786
Debt securities issued by non-US governments	-	84,099	-	84,099	-	90,042	-	90,042
Corporate debt securities guaranteed by non-US governments	-	-	-	-	-	32,026	-	32,026
Corporate debt securities	-	378,816	-	378,816	-	421,085	-	421,085
Asset-backed securities - Student loans	-	76,265	11,297	87,562	-	124,937	11,164	136,101
Mortgage-backed securities - Commercial	-	142,368	-	142,368	-	130,478	-	130,478
Mortgage-backed securities - Prime	-	23,461	-	23,461	-	-	-	-
Pass-through note	-	-	36,334	36,334	-	-	30,646	30,646
Equity securities	-	50	-	50	-	53	-	53
<b>Total Available for sale</b>	<b>-</b>	<b>2,365,630</b>	<b>47,631</b>	<b>2,413,261</b>	<b>-</b>	<b>2,538,767</b>	<b>41,810</b>	<b>2,580,577</b>
Other assets - Derivatives	-	12,051	-	12,051	-	14,425	-	14,425
Other assets - Closed ended real estate fund	-	-	-	-	-	-	4,397	4,397
<b>Financial liabilities</b>								
Other liabilities – Derivatives	-	(17,588)	-	(17,588)	-	(24,956)	-	(24,956)

There were no transfers between Level 1 and Level 2 during 30 June 2013 and 31 December 2012.

The following table presents quantitative information about recurring fair value measurements of assets classified with Level 3 of the fair value hierarchy as of 30 June 2013.

Financial Instrument Type	Valuation Technique	Fair Value
Asset-backed securities - Student loans	Unadjusted third party priced	11,297
Pass-through note	Unadjusted third party priced	36,334

The valuation techniques used for the Level 3 assets as presented in the above table, are described as follows:

#### Unadjusted third party priced

Prices obtained from third party pricing vendors or brokers that are used to record the fair value of the asset of which the related valuation technique and significant unobservable inputs are not provided.

- Asset-backed securities ("ABS") – The ABS is a Federal Family Education Loan Program guaranteed student loan security and is valued using a non-binding broker quote. The fair value provided by the broker is based on the last trading price of similar securities but as the security is trading illiquidly, a Level 2 classification is not supported.
- Pass-through note ("PTN") – The PTN consists of a pool of floating rate income securities (typically US sub prime collateralised mortgage obligations and mortgage-backed securities). The third-party investment manager of the PTN determines the fair value of each underlying security within the PTN. The investment manager uses a variety of valuation techniques consistent with those disclosed in Note 2 in Bank's audited financial statements for the year ending 31 December 2012. Despite relying on the fair values provided by the investment manager, Management is still responsible for the final fair valuation used.

Significant increases (decreases) in any of the above inputs in isolation could result in a significantly different fair value measurement. Generally a change in assumption used for the probability of defaults is accompanied by a directionally similar change in the assumption used for the loss severity.

**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 13: Fair Value of Financial Instruments (continued)**

**Level 3 reconciliation**

	For the six month period ended			
	30 June 2013		30 June 2012	
	Available-for-sale investments	Closed ended property fund	Available-for-sale investments	Closed ended property fund
Carrying amount at beginning of year	41,810	4,397	38,155	6,199
Purchases	-	-	-	-
Proceeds from sale / Capital distributions	(3,038)	(4,111)	(2,643)	(1,154)
Accretion recognised in net income	969	-	888	-
Realised and unrealised gains (losses) recognised in other comprehensive income	7,890	-	2,979	33
Transfers in and out of Level 3	-	-	-	-
Foreign exchange translation adjustment	-	(286)	-	119
<b>Carrying amount at end of period</b>	<b>47,631</b>	<b>-</b>	<b>39,379</b>	<b>5,197</b>

	30 June 2013 Fair value			Total carrying amount / Fair value	31 December 2012 Fair value			Total carrying amount / Fair value
	Level 1	Level 2	Level 3		Level 1	Level 2	Level 3	
<b>Items that are recognised at fair value on a non-recurring basis</b>								
Other real estate owned	-	32,772	-	32,772	-	34,360	-	34,360

The current carrying value of other real estate owned will be adjusted to fair value only when there is devaluation below cost.

**Items other than those recognised at fair value on a recurring basis**

	30 June 2013				31 December 2012		
	Carrying amount	Fair value	Appreciation / (depreciation)		Carrying amount	Fair value	Appreciation / (depreciation)
<b>Financial assets</b>							
Cash and cash equivalents	1,686,761	1,686,761	-		1,542,526	1,542,526	-
Short-term investments	66,429	66,429	-		76,213	76,213	-
Investments held to maturity	294,418	284,640	(9,778)		239,342	244,793	5,451
Loans, net of allowance for credit losses	4,103,359	4,101,050	(2,309)		3,955,960	3,946,081	(9,879)
<b>Financial liabilities</b>							
Customer deposits							
Demand deposits	5,845,698	5,845,698	-		5,324,105	5,324,105	-
Term deposits	1,734,153	1,735,733	(1,580)		1,942,667	1,944,531	(1,864)
Deposits from banks	70,121	70,121	-		126,466	126,466	-
Securities sold under repurchase agreements	150,889	150,889	-		109,021	109,021	-
Subordinated capital	207,000	199,073	7,927		260,000	254,127	5,873

All of the Held to maturity securities held by the Bank as at 30 June 2013 and 31 December 2012 are classified as Level 2 of the fair value hierarchy.

**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 14: Interest Rate Risk**

The following table sets out the assets, liabilities and Shareholders' equity and off-Balance Sheet instruments on the date of the earlier of contractual maturity, expected maturity or repricing date. Use of this table to derive information about the Bank's interest rate risk position is limited by the fact that customers may choose to terminate their financial instruments at a date earlier than the contractual maturity or repricing date. Examples of this include fixed-rate mortgages, which are shown at contractual maturity but which may pre-pay earlier, and certain term deposits, which are shown at contractual maturity but which may be withdrawn before their contractual maturity subject to prepayment penalties. Investments are shown based on remaining contractual maturities. The remaining contractual principal maturities for mortgage-backed securities (primarily US Government agencies) do not consider prepayments. Remaining expected maturities will differ from contractual maturities because borrowers may have the right to prepay obligations before the underlying mortgages mature.

30 June 2013		Earlier of maturity or repricing date					Total
(in \$ millions)	Within 3 months	3 to 6 months	6 to 12 months	1 to 5 years	After 5 years	Non-interest bearing funds	
<b>Assets</b>							
Cash and cash equivalents	1,460	-	-	-	-	227	1,687
Short-term investments	57	3	6	-	-	-	66
Investments	186	136	4	532	1,855	56	2,769
Loans	3,745	83	3	122	73	77	4,103
Other assets	-	-	-	-	-	372	372
<b>Total assets</b>	<b>5,448</b>	<b>222</b>	<b>13</b>	<b>654</b>	<b>1,928</b>	<b>732</b>	<b>8,997</b>
<b>Liabilities and Shareholders' equity</b>							
Shareholders' equity	-	-	-	-	-	785	785
Demand deposits	4,944	-	-	-	-	945	5,889
Term deposits	1,391	165	129	76	-	-	1,761
Securities sold under agreement to repurchase	151	-	-	-	-	-	151
Other liabilities	-	-	-	-	-	204	204
Subordinated capital	137	-	-	70	-	-	207
<b>Total liabilities and Shareholders' equity</b>	<b>6,623</b>	<b>165</b>	<b>129</b>	<b>146</b>	<b>-</b>	<b>1,934</b>	<b>8,997</b>
<b>Interest rate swaps</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Interest rate sensitivity gap	(1,175)	57	(116)	508	1,928	(1,202)	-
Cumulative interest rate sensitivity gap	(1,175)	(1,118)	(1,234)	(726)	1,202	-	-

31 December 2012		Earlier of maturity or repricing date					Total
(in \$ millions)	Within 3 months	3 to 6 months	6 to 12 months	1 to 5 years	After 5 years	Non-interest bearing funds	
<b>Assets</b>							
Cash and cash equivalents	1,326	-	-	-	-	217	1,543
Short-term investments	64	8	4	-	-	-	76
Investments	673	314	43	559	1,236	57	2,882
Loans	3,490	180	41	100	94	51	3,956
Other assets	-	-	-	-	-	376	376
<b>Total assets</b>	<b>5,553</b>	<b>502</b>	<b>88</b>	<b>659</b>	<b>1,330</b>	<b>701</b>	<b>8,833</b>
<b>Liabilities and Shareholders' equity</b>							
Shareholders' equity	-	-	-	-	-	857	857
Demand deposits	4,505	-	-	-	-	919	5,424
Term deposits	1,576	204	108	81	-	-	1,969
Securities sold under agreement to repurchase	109	-	-	-	-	-	109
Other liabilities	-	-	-	-	-	214	214
Subordinated capital	90	100	-	45	25	-	260
<b>Total liabilities and Shareholders' equity</b>	<b>6,280</b>	<b>304</b>	<b>108</b>	<b>126</b>	<b>25</b>	<b>1,990</b>	<b>8,833</b>
<b>Interest rate swaps</b>	<b>8</b>	<b>-</b>	<b>(8)</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>
Interest rate sensitivity gap	(719)	198	(28)	533	1,305	(1,289)	-
Cumulative interest rate sensitivity gap	(719)	(521)	(549)	(16)	1,289	-	-

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 15: Earnings per Share

Earnings per Share have been calculated using the weighted average number of Common Shares outstanding during the year after deduction of the Shares held as Treasury stock. The dilutive effect of Share-based compensation plans was calculated using the Treasury stock method, whereby the proceeds received from the exercise of Share-based awards are assumed to be used to repurchase outstanding Shares, using the average market price of the Bank's Shares for the year. Diluted earnings per Common Share include the dilutive effect resulting from the conversion of Treasury stock. Numbers of Shares are expressed in thousands.

	For the three month period ended		For the six month period ended	
	30 June 2013	30 June 2012	30 June 2013	30 June 2012
<b>Basic Earnings per Share <sup>(1)</sup></b>	<b>0.05</b>	0.02	<b>0.06</b>	0.04
Basic earnings per Share from continuing operations	0.05	0.02	0.06	0.04
Basic earnings per Share from discontinued operations	-	-	-	-
Net income for the year	32,923	16,040	46,210	30,603
Less: Preference dividends declared and guarantee fee	(4,292)	(4,500)	(8,688)	(9,000)
Less: Premium paid on Preferred Share buy back	(2,516)	-	(2,567)	-
Net income from continuing operations attributable for Common Shareholders	26,115	11,540	34,955	21,603
Net income from discontinued	-	202	-	320
<b>Net income attributable for Common Shareholders</b>	<b>26,115</b>	<b>11,742</b>	<b>34,955</b>	<b>21,923</b>
Weighted average number of participating Shares	556,933	556,933	556,933	556,933
Weighted average number of Common Shares held as Treasury stock	(7,160)	(1,105)	(7,171)	(1,527)
<b>Adjusted weighted average number of Common Shares</b>	<b>549,773</b>	<b>555,828</b>	<b>549,762</b>	<b>555,406</b>
<b>Diluted Earnings per Share <sup>(1)</sup></b>	<b>0.05</b>	0.02	<b>0.06</b>	0.04
Diluted earnings per Share from continuing operations	0.05	0.02	0.06	0.04
Diluted earnings per Share from discontinued operations	-	-	-	-
Net income from continuing operations attributable for Common Shareholders	26,115	11,540	34,955	21,603
Net income from discontinued	-	202	-	320
<b>Net income attributable for Common Shareholders</b>	<b>26,115</b>	<b>11,742</b>	<b>34,955</b>	<b>21,923</b>
Adjusted weighted average number of Common Shares	549,773	555,828	549,762	555,406
Weighted average number of dilutive Share-based awards	3,791	2,665	3,766	2,182
<b>Adjusted weighted average number of diluted Common Shares</b>	<b>553,564</b>	<b>558,493</b>	<b>553,528</b>	<b>557,588</b>

<sup>(1)</sup> Due to rounding, earnings per Share on continuing and discontinued operations may not sum to earnings per Share amount on net income

The Contingent Value Convertible Preference Shares are classified as participating securities as they are entitled to dividends declared to Common Shareholders on a 1:1 basis and are therefore included in the basic earnings per Share calculation.

During the six months ended 30 June 2013, weighted-average options to purchase 32.9 million (2012: 33.0 million) Shares of Common stock (see Note 16), were outstanding. Only options where the option's expense that will be recognised in the future and its exercise price was lower than the average market price of the Bank's Common stock were considered dilutive and, therefore, included in the computation of diluted earnings per Share. The dilution effect of such options is a net increase of 1.1 million of the weighted-average number of Common Shares outstanding on a fully diluted basis. The awards' yet unrecognised expense is considered to be the proceeds the employees would need to pay to purchase accelerated vesting of the awards.

During the six months ended 30 June 2013 the weighted-average number of outstanding awards of unvested Common Shares (see Note 16) was 8.6 million (2012: 7.2 million). All unvested awards of Common Shares were considered dilutive because each award's unrecognised expense was lower than the average market price of the Bank's Common stock. The awards' unrecognised expense is considered to be the proceeds the employees would need to pay to purchase accelerated vesting of the awards. For purpose of calculating dilution, such proceeds are assumed to be used by the Bank to buy-back Shares at the average market price. The weighted-average number of outstanding awards net of the assumed weighted-average number of Shares bought-back is included in the number of diluted participating Shares.

Warrants issued to the Government of Bermuda in exchange for the Government's guarantee of the Preference Shares, with an exercise price of \$3.51 (2012: \$3.61) for 4.28 million (2012: 4.15 million) Shares of Common stock were not included in the computation of earnings per Share as at 30 June 2013 and 2012 because the exercise price was greater than the average market price of the Bank's Common stock.

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 16: Share-Based Payments

As at 30 June 2013, the Bank has three Share-based compensation plans, which are described below.

#### Stock Option Plans

##### 1997 Stock Option Plan

Prior to the capital raise on 2 March 2010, the Bank granted stock options to employees and Directors of the Bank that entitle the holder to purchase one Common Share at a subscription price equal to the market price on the effective date of the grant. Generally, the options granted vest 25 percent at the end of each year for four years, however as a result of capital raise, the options granted under the Bank's 1997 Stock Option Plan to employees became fully vested and options awarded to certain executives were surrendered.

##### 2010 Stock Option Plan

In conjunction with the capital raise, the Board of Directors approved the 2010 Stock Option Plan. Under the Plan, five per cent of the Company's fully diluted Common Shares, equal to approximately 29.5 million Shares, are available for grant to certain Officers. During May 2012 the Board of Directors approved an increase to the options allowed to be granted under the 2010 Stock Option Plan to 50 million Shares.

Under the 2010 Stock Option Plan, options are awarded to Bank employees and Executive Management, based on predetermined vesting conditions that entitle the holder to purchase one Common Share at a subscription price usually equal to the last-traded Common Share price when granted and have a term of 10 years. Two types of vesting conditions upon which the options will be awarded comprise the Plan i.e.:

##### Time Vesting Condition

50% of each option award is granted in the form of Time Vested Options and vests 25% on each of the second, third, fourth and fifth anniversaries of the effective grant date, subject to the employee's continued employment; and

##### Performance Vesting Condition

50% of each option award is granted in the form of Performance Options and vests on a "Valuation Event" date (date any of the 2 March 2010 Investors transfers at least 5% of total number of Shares or the date that there is a change in control) and any of the New Investors achieve a Multiple of Invested Capital ("MOIC") based on predetermined MOIC tiers. In the event of a Valuation Event and the MOIC reaching 200% of the original \$1.21 per Share invested capital, all options would vest.

The Bank determined the performance stock options granted have an aggregate fair value of \$9.5 million. If the probability of a Valuation Event becomes more likely than not, some or all of the \$9.5 million unrecognised expense relating to the performance vesting options will be recognised as an expense.

The table below presents the number of Shares transferable upon exercise of the options outstanding:

#### Stock option plans

	For the six month period ended	
	30 June 2013	30 June 2012
	Number of shares transferable upon exercise (in thousands)	Number of shares transferable upon exercise (in thousands)
Outstanding at beginning of period	33,327	33,632
Granted	-	100
Exercised	(75)	(6)
Forfeited / cancelled	(196)	(448)
Resignations / Retirement / Redundancy	(8)	(303)
End of plan expiration	(255)	-
<b>Outstanding at end of period</b>	<b>32,793</b>	<b>32,975</b>

#### Employee Deferred Incentive Plan ("EDIP")

Under the Bank's EDIP Plan, Shares were awarded to Bank employees and Executive Management based on time-vesting condition, which states that the Shares will vest equally over a three-year period from the effective grant date, subject to the employee's continued employment. The table below presents the number of Shares transferable upon vesting of the shares:

#### EDIP

	For the six month period ended	
	30 June 2013	30 June 2012
	Number of shares transferable upon vesting (in thousands)	Number of shares transferable upon vesting (in thousands)
Outstanding at beginning of period	1,976	1,276
Granted	1,249	1,565
Vested	(755)	(477)
Resignations / Retirement / Redundancy	(152)	(381)
Forfeited / cancelled	(7)	(13)
Granted due to participation in dividends	87	-
<b>Outstanding at end of period</b>	<b>2,398</b>	<b>1,970</b>

# The Bank of N.T. Butterfield & Son Limited

## Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

### Note 16: Share-Based Payments (continued)

#### 2011 and 2012 Executive Long-Term Incentive Share plan ("ELTIP")

Under the Bank's ELTIP, Shares were awarded to Bank employees and Executive Management, based on predetermined vesting conditions. Two types of vesting conditions upon which the Shares will be awarded comprise the ELTIP Plan i.e.:

**Time Vesting Condition** - 50% of each Share award is granted in the form of Time Vested Shares, vesting equally over a three-year period from the effective grant date, subject to the employee's continued employment; and

**Performance Vesting Condition** - 50% of each Share award is granted in the form of Performance Shares, vesting upon the achievement of certain performance targets in the three-year period from the effective grant date

#### 2013 Executive Long-Term Incentive Share plan ("2013 ELTIP")

Under the Bank's 2013 ELTIP, Shares were awarded to Executive Management, based on predetermined vesting conditions. The vesting condition upon which the Shares will be awarded is as follows:

**Performance Vesting Condition** - 100% of each Share award is granted in the form of Performance Shares, vesting upon the achievement of certain performance targets in the three-year period from the effective grant date

The Board approved the 2013 Employee Deferred Incentive Plan and the 2013 Executive Long-Term Incentive Share Plan on the 26<sup>th</sup> of February 2013.

The table below presents the number of Shares transferable upon vesting of the shares:

ELTIP	For the six month period ended	
	30 June 2013	30 June 2012
	Number of shares transferable upon vesting (in thousands)	Number of shares transferable upon vesting (in thousands)
Outstanding at beginning of period	5,230	2,515
Granted	3,193	4,067
Vested	(900)	(931)
Resignations / Retirement / Redundancy	(153)	(425)
Forfeited / cancelled	(1,059)	(20)
Granted due to participation in dividends	236	-
<b>Outstanding at end of period</b>	<b>6,547</b>	<b>5,206</b>

The following table presents the Share-based compensation cost that has been charged against net income and the value of Share-based settlements.

	For the six months ended			30 June 2012		
	30 June 2013			30 June 2012		
	Stock option plans	EDIP and ELTIP	Total	Stock option plans	EDIP and ELTIP	Total
<b>Share-based compensation plans – continuing operations</b>						
Employees' incentive benefits	840	2,219	3,059	760	1,743	2,503
<b>Share-based settlement plans</b>						
Directors' Shares and retainers settlement plans			151			114
<b>Total Share-based payments</b>			<b>3,210</b>			<b>2,617</b>

The following table presents the unrecognised expense attributable each plan.

Unrecognised expense	As at	
	30 June 2013	30 June 2012
<b>Stock Option Plan</b>		
Time Vesting Options	2,671	4,817
Performance Vesting Options	9,513	9,045
<b>EDIP</b>	<b>2,432</b>	<b>2,104</b>
<b>ELTIP</b>		
Time Vesting Shares	1,298	2,564
Performance Vesting Shares	5,147	2,571
	<b>21,061</b>	<b>21,101</b>

#### Directors' Compensation

The Bank's Non-Executive Directors received their annual retainer compensation in the form of cash or fully vested and unrestricted Bank Shares.



## The Bank of N.T. Butterfield & Son Limited

### Notes to the Unaudited Consolidated Financial Statements (continued)

(in thousands of Bermuda dollars)

#### Note 17: Share Buy-Back Plans

The Bank introduced two Share Buy-back Programmes on 1 May 2012 as a means to improve Shareholder liquidity and facilitate growth in Share value. Under these Programmes, up to six million Common Shares were authorised to be acquired and 2,000 Preference Shares were authorised to be purchased for cancellation. On 10 December 2012, the Board of the Bank approved increasing the number of Common Shares to be acquired up to 10 million and number of Preference Shares to be purchased for cancellation up to 8,000. The Board cancelled the existing Common Share Buy-back Programme effective 1 April 2013 and implemented a new programme for the purchase of up to 10 million Common Shares. During the second quarter of 2013, the Board also implemented a new Preference Share Buy-back programme to replace the old programme (under which the Bank was authorised to purchase for cancellation up to 8,000 Preference Shares), authorising in total the purchase and cancellation of up to 15,000 Preference Shares.

During the period ended 30 June 2013 the Bank acquired 1.6 million Common Shares to be held as Treasury Shares at an average cost of \$1.40 per Share (total cost of \$2.3 million), and purchased for cancellation 10,800 Preference Shares at a cost of \$13.3 million.

From time to time the Bank's associates, insiders and insiders' associates as defined by the BSX regulations may sell Shares which may result in such Shares being repurchased pursuant to the programme, but under BSX regulations such trades must not be pre-arranged and all repurchases must be made in the open market. Prices paid by the Bank must not, according to BSX regulations, be higher than the last independent trade for a "round lot", defined as 100 Shares or more.

The BSX must be advised monthly of Shares repurchased and cancelled by the Bank.

#### Note 18: Accumulated other comprehensive income

The table below presents the changes in Accumulated Other Comprehensive Income (Loss) by component for the six month period ended:

30 June 2013	Unrealised losses on translation of net investment in foreign operations	Unrealised gains (losses) on available for sale investments	Employee future benefits liability	Total
Balance at beginning of period	(10,487)	44,781	(46,817)	(12,523)
Other comprehensive loss	(2,319)	(64,517)	(1,443)	(68,279)
<b>Balance at end of period</b>	<b>(12,806)</b>	<b>(19,736)</b>	<b>(48,260)</b>	<b>(80,802)</b>

30 June 2012:

	Unrealised losses on translation of net investment in foreign operations	Unrealised gains on available for sale investments	Employee future benefits liability	Total
Balance at beginning of period	(11,321)	1,663	(31,644)	(41,302)
Other comprehensive loss	(306)	19,634	(1,740)	17,588
<b>Balance at end of period</b>	<b>(11,627)</b>	<b>21,297</b>	<b>(33,384)</b>	<b>(23,714)</b>

**The Bank of N.T. Butterfield & Son Limited**  
**Notes to the Unaudited Consolidated Financial Statements (continued)**

(in thousands of Bermuda dollars)

**Note 18: Accumulated other comprehensive income (continued)**

The net change in each component of Accumulated Other Comprehensive Income (Loss) is as follow:

Consolidated Statement of Operations line item		For the three month period ended		For the six month period ended	
		30 June 2013	30 June 2012	30 June 2013	30 June 2012
<b>Net unrealised (loss) gains on translation of net investment in foreign operations adjustments</b>					
Foreign Currency Translation Adjustments		435	(3,553)	(13,436)	1,837
Net Investment Hedge Gains (Losses)		(358)	3,140	11,117	(2,143)
Net change		77	(413)	(2,319)	(306)
<b>Available for sale investment adjustments</b>					
Gross unrealised (loss) gains arising during the period		(58,918)	2,050	(64,461)	21,435
Reclassification of realised losses(gains) to net income		(16)	276	(56)	(1,801)
Net change		(58,934)	2,326	(64,517)	19,634
<b>Employee future benefits adjustments</b>					
Amortisation of actuarial gains (losses) on defined benefit pension	Salaries and other employee benefits	315	292	705	583
Amortisation of actuarial gains (losses) on post-retirement medical benefit	Salaries and other employee benefits	274	518	1,212	1,037
Amortisation of prior period service cost on post-retirement medical benefit	Salaries and other employee benefits	(1,680)	(1,680)	(3,360)	(3,360)
Net change		(1,091)	(870)	(1,443)	(1,740)
<b>Other comprehensive (loss) income</b>		(59,948)	1,043	(68,279)	17,588

**Note 19: Regulatory capital**

The Bank is fully compliant with all regulatory capital requirements and maintains capital ratios well in excess of regulatory minimums as at 30 June 2013 and 31 December 2012.

The following table sets forth our capital adequacy in accordance with Basel I framework:

(in \$ millions)	30 June 2013	31 December 2012
<b>Capital</b>		
Tier 1 capital	787,957	792,266
Tier 2 capital	183,045	244,225
Deductions	(2,935)	(2,935)
Total capital	968,067	1,033,556
<b>Weighted Risk Assets</b>		
Total weighted risk assets	4,285,889	4,275,055
<b>Capital Ratios (%)</b>		
Tier 1 Common	14.1%	14.0%
Tier 1 Total	18.4%	18.5%
Total Capital	22.6%	24.2%

## **The Bank of N.T. Butterfield & Son Limited**

### **Notes to the Unaudited Consolidated Financial Statements (continued)**

*(in thousands of Bermuda dollars)*

#### **Note 20: Variable Interest Entities**

The Bank had no investments in variable interest entities for which it was deemed the primary beneficiary for the periods ended 30 June 2013 and 2012.

The Bank has equitable mortgages in two hospitality-related companies that have been placed under Receivership, and as the Bank is an equity holder at risk, the hospitality-related companies were considered to be variable interest entities. As the Bank did not have the legal power to direct the activities of the companies that most significantly impact the company's economic performance it was considered not to be the primary beneficiary.

#### **Note 21: Related party transactions**

##### **Charitable Trust**

The Bank historically has provided a loan facility to the Charitable Trust. During December 2012 the carrying value of the loan was repaid and subsequently the Charitable Trust was terminated.

##### **Financing transactions**

Certain directors of the Bank, companies in which they are principal owners, and trusts in which they are involved, have loans with the Bank. These loans were made in the ordinary course of business at normal credit terms, including interest rate and collateral requirements. As of 30 June 2013, related party director loan balances were \$68.8 million.

On 27 June 2013, the Bank executed a \$95 million loan agreement with an investment fund managed by a significant shareholder which provides for maturity on 30 June 2017. This loan was made in the ordinary course of business on normal commercial terms. At 30 June 2013, \$95 million was outstanding under this agreement. For the six months ending 30 June 2013, no interest income recognised has been recognised as the loan was extended on the last day of the month.

##### **Capital transaction**

Canadian Imperial Bank of Commerce ("CIBC") and funds associated with the Carlyle Group each hold approximately 19%, of the Bank's equity voting power, along with the right to each designate two persons for nomination for election by the Shareholders as members of the Bank's Board of Directors.

##### **Balance Sheet management advisory agreement**

From 1 October 2010, the Bank had retained Carlyle Investment Management LLC, an affiliated company of the Carlyle Group, to provide Balance Sheet management advisory services, including advisory services on valuation assignments, for an annual fee of \$4 million for a three-year period. Effective 31 July 2012, the investment advisory business previously conducted by Carlyle Investment Management LLC was transferred to Alumina Investment Management LLC ("Alumina") and the Bank agreed to the transfer of its contract to Alumina. The Carlyle Group holds a 15% interest in Alumina and as Alumina is not considered affiliated with the Carlyle Group, the related-party transaction ceased on the effective date.

#### **Note 22: Comparative Information**

Certain prior-year figures have been reclassified to conform to current year presentation and restated for discontinued operations.

#### **Note 23: Subsequent Events**

The Bank has performed an evaluation of subsequent events through to 30 July 2013, the date the financial statements were issued.

On 30 July 2013, the Board declared an interim dividend of \$0.01 per Common and Contingent Value Convertible Preference Share to be paid on 23 August 2013 to shareholders of record on 9 August 2013.