A Foundation for *Growth*

Butterfield

Financial Results 2012

The Bank of N.T. Butterfield & Son Limited

Financial results for the 12 months ended 31 December 2012

February 26, 2013

Independent Auditor's Report

To the Shareholders of
The Bank of N.T. Butterfield & Son Limited

We have audited the accompanying consolidated financial statements of **The Bank of N.T. Butterfield & Son Limited** and its subsidiaries, which comprise the consolidated balance sheets as at December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), shareholders' equity and cash flows for the years then ended.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibility

Our responsibility is to express an opinion on the consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to the Company's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

To the Shareholders of
The Bank of N.T. Butterfield & Son Limited
February 26, 2013

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of **The Bank of N.T. Butterfield & Son Limited** and its subsidiaries at December 31, 2012 and 2011 and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

PricewaterhouseCoopers

Chartered Accountants

The Bank of N.T. Butterfield & Son Limited
Consolidated Balance Sheet

As at 31 December (in thousands of Bermuda dollars)

	2012	2011
Assets		
Cash and demand deposits with banks	476,071	383,827
Cash equivalents	1,175,476	1,518,899
Total cash and cash equivalents	1,651,547	1,902,726
Short-term investments	76,213	20,280
Debt and equity securities		
Trading	61,785	62,591
Available for sale	2,580,577	1,934,259
Held to maturity	239,342	64,789
Total investments in debt and equity securities	2,881,704	2,061,639
Loans, net of allowance for credit losses	3,955,960	4,069,419
Premises, equipment and computer software	243,321	272,472
Accrued interest	18,975	24,094
Goodwill	6,949	15,937
Intangible assets	15,327	30,163
Investments in affiliates	18,637	32,582
Other real estate owned	34,360	27,354
Other assets	39,037	60,640
Assets of discontinued operations	-	307,044
Total assets	8,942,030	8,824,350
Liabilities		
Deposits		
Non-interest bearing	918,814	904,873
Interest bearing		
Customers	6,456,979	6,226,122
Banks	126,466	125,566
Total deposits	7,502,259	7,256,561
Securities sold under agreement to repurchase	109,021	-
Employee future benefits	103,135	104,913
Accrued interest	2,795	7,865
Preference Share dividends payable	662	715
Other liabilities	106,984	84,767
Liabilities of discontinued operations	-	272,049
Total other liabilities	322,597	470,309
Subordinated capital	260,000	267,755
Total liabilities	8,084,856	7,994,625
Shareholders' equity		
Common Share capital (BMD 0.01 par; authorised Shares 26,000,000,000) issued and outstanding: 549,677,803 (2011: 549,468,349)	5,496	5,494
Preference Share capital (USD 0.01 par; USD 1,000 liquidation Preference) issued and outstanding: 195,578 (2011: 200,000)	2	2
Contingent Value Convertible Preference Share capital (USD 0.01 par) issued and outstanding: 7,254,732 (2011: 7,464,186)	73	75
Additional paid-in capital	1,355,689	1,377,556
Accumulated deficit	(482,796)	(490,377)
Less: Treasury Common Shares: 7,066,586 Shares (2011: 2,163,958 Shares)	(8,767)	(21,723)
Accumulated other comprehensive loss	(12,523)	(41,302)
Total Shareholders' equity	857,174	829,725
Total liabilities and Shareholders' equity	8,942,030	8,824,350

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

Brendan McDonagh
Chairman & Chief Executive Officer

The Bank of N.T. Butterfield & Son Limited
Consolidated Statements of Operations

For the year ended 31 December (in thousands of Bermuda dollars, except per Share data)

	2012	2011
Non-interest income		
Asset management	22,323	22,942
Banking	33,713	31,648
Foreign exchange revenue	26,524	30,277
Trust	29,122	29,451
Custody and other administration services	10,646	12,324
Other non-interest income	6,215	5,707
Total non-interest income	128,543	132,349
Interest income		
Loans	190,691	188,041
Investments	49,117	43,816
Deposits with banks	4,999	9,636
Total interest income	244,807	241,493
Interest expense		
Deposits	21,158	28,756
Subordinated capital	12,573	10,486
Securities sold under repurchase agreement	18	2
Total interest expense	33,749	39,244
Net interest income before provision for credit losses	211,058	202,249
Provision for credit losses	(14,190)	(13,169)
Net interest income after provision for credit losses	196,868	189,080
Net realised / unrealised gains (losses) on trading investments	268	(919)
Net realised gains on available for sale investments	2,028	2,058
Net realised / unrealised losses on Other real estate owned	(2,053)	-
Gain on sale of affiliates	4,231	3,178
Impairment of fixed assets	(14,527)	-
Impairment of intangible assets	(9,143)	-
Impairment of goodwill	(9,505)	-
Net other gains (losses)	1,389	(79)
Total other (losses) gains	(27,312)	4,238
Total net revenue	298,099	325,667
Non-interest expense		
Salaries and other employee benefits	137,433	145,136
Technology and communications	57,715	53,929
Property	26,129	27,080
Professional and outside services	15,409	18,430
Non-income taxes	13,158	14,029
Amortisation of intangible assets	5,040	5,367
Marketing	3,963	4,891
Other expenses	15,401	17,766
Total non-interest expense	274,248	286,628
Net income before income taxes from continuing operations	23,851	39,039
Income tax (expense) benefit	(5,890)	306
Net income from continuing operations	17,961	39,345
Discontinued operations		
Income from discontinued operations	693	1,401
Gain on sale of discontinued operations	7,240	-
Income tax expense	(313)	(274)
Net income from discontinued operations	7,620	1,127
Net income	25,581	40,472
Cash dividends declared on Contingent Value Convertible Preference Shares	-	(3,270)
Cash dividends declared on Preference Shares	(16,000)	(16,000)
Preference Shares guarantee fee	(2,000)	(2,000)
Net income attributable to Common Shareholders	7,581	19,202
Earnings per Common Share		
Basic Earnings per Share	0.01	0.03
Diluted Earnings per Share	0.01	0.03
Basic Earnings per Share from continuing operations	-	-
Diluted Earnings per Share from continuing operations	-	-

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

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

For the year ended 31 December (in thousands of Bermuda dollars)

	2012	2011
Net income	**25,581**	40,472
Other comprehensive income (loss)		
Net change in unrealised gains on translation of net investment in foreign operations	**834**	823
Net change in unrealised gains on available for sale investments	**43,118**	19,845
Net change in employee future benefits liability	**(15,173)**	(23,356)
Other comprehensive income (loss)	**28,779**	(2,688)
Total comprehensive income	**54,360**	37,784

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

The Bank of N.T. Butterfield & Son Limited
Consolidated Statements of Changes in Shareholders' Equity

For the year ended 31 December (in thousands of Bermuda dollars)

	2012	2011
Common Share capital issued and outstanding		
Balance at beginning of year (2012: 549,468,349 Shares; 2011: 549,143,448 Shares)	**5,494**	5,491
Conversion of Contingent Value Convertible Preference Shares (2012: 209,454 Shares; 2011: 324,901 Shares)	**2**	3
Balance at end of year (2012: 549,677,803 Shares; 2011: 549,468,349 Shares)	**5,496**	5,494
Preference Shares		
Balance at beginning of year (2012: 200,000 Shares; 2011: 200,000 Shares)	**2**	2
Repurchase and cancellation of Preference Shares (2012: 4,422 Shares; 2011: nil Shares)	**-**	-
Balance at end of year (2012: 195,578 Shares; 2011: 200,000 Shares)	**2**	2
Contingent Value Convertible Preference Shares		
Balance at beginning of year (2012: 7,464,186 Shares; 2011: 7,789,087)	**75**	78
Conversion to Common Shares (2012: 209,454 Shares; 2011: 324,901 Shares)	**(2)**	(3)
Balance at end of year (2012: 7,254,732 Shares; 2011: 7,464,186 Shares)	**73**	75
Additional paid-in capital		
Balance at beginning of year	**1,377,556**	1,376,037
Stock option plan expense	**5,184**	3,567
Reduction of additional paid-in capital on transfer of Treasury Shares	**(21,662)**	(2,048)
Reduction of additional paid-in capital on repurchase and cancellation of Preference Shares	**(5,389)**	-
Balance at end of year	**1,355,689**	1,377,556
Accumulated deficit		
Balance at beginning of year	**(490,377)**	(509,579)
Net income for year	**25,581**	40,472
Cash dividends declared on Contingent Value Convertible Preference Shares	**-**	(3,270)
Cash dividends declared on Preference Shares	**(16,000)**	(16,000)
Preference Shares guarantee fee	**(2,000)**	(2,000)
Balance at end of year	**(482,796)**	(490,377)
Treasury Common Shares		
Balance at beginning of year (2012: 2,163,958 Shares; 2011: 2,401,593 Shares)	**(21,723)**	(24,127)
Share-based compensation	**293**	356
Purchases of Treasury Shares (2012: 7,260,051 Shares; 2011: nil Shares)	**(8,999)**	-
Net transfers of Treasury Shares	**21,662**	2,048
Balance at end of year (2012: 7,066,586 Shares; 2011: 2,163,958 Shares)	**(8,767)**	(21,723)
Accumulated other comprehensive loss		
Balance at beginning of year	**(41,302)**	(38,614)
Other comprehensive income	**28,779**	(2,688)
Balance at end of year	**(12,523)**	(41,302)
Total Shareholders' equity	**857,174**	829,725
Components of accumulated other comprehensive loss		
Cumulative unrealised losses on translation of investment in foreign operations	**(10,487)**	(11,321)
Cumulative unrealised gains on available for sale investments	**44,781**	1,663
Cumulative change in employee future benefits liability	**(46,817)**	(31,644)
Balance at end of year	**(12,523)**	(41,302)

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

The Bank of N.T. Butterfield & Son Limited
Consolidated Statements of Cash Flows

For the year ended 31 December (in thousands of Bermuda dollars)

	2012	2011
Cash flows from operating activities		
Net income from continuing operations	25,581	40,472
Less: Net income from discontinued operations	(7,620)	(1,127)
Net income	17,961	39,345
Adjustments to reconcile net income to operating cash flows:		
Depreciation and amortisation	46,958	37,930
Impairment of goodwill	9,505	-
Impairment of intangible assets	9,143	-
Impairment of fixed assets	14,527	-
Decrease in carrying value of investments in affiliates	(288)	952
Share-based payments	5,477	3,923
Net gain on sale of affiliate	(4,231)	(3,178)
Net realised / unrealised losses on other real estate owned	2,053	-
Net gain on repayment of sub-debt	-	(1,125)
Net realised gains of available for sale securities	(2,028)	(2,058)
Provision for credit losses	14,190	13,170
Net change in net assets from discontinued operations	-	(130)
Changes in operating assets and liabilities:		
Decrease (increase) in accrued interest receivable	5,393	(7,883)
Decrease in other assets	22,813	12,427
Decrease in accrued interest payable	(5,129)	(948)
Decrease in other liabilities and employee future benefits	(4,498)	(8,576)
	131,846	83,849
Net change in trading investments	1,069	(44,422)
Cash provided by operating activities from continuing operations	132,915	39,427
Cash flows from investing activities		
Net increase in short-term investments	(55,498)	(774)
Net proceeds on sale of affiliate	18,464	3,178
Net proceeds on sale of subsidiary	41,862	-
Net proceeds on sale of intangible assets	1,428	-
Additions to premises, equipment and computer software	(17,761)	(33,612)
Proceeds from Other real estate owned	4,726	-
Net decrease (increase) in loans	137,077	(261,370)
Held to maturity investments: proceeds from pay downs	16,127	-
Held to maturity investments: purchases	(191,305)	(64,789)
Available for sale investments: proceeds from sale	414,347	971,540
Available for sale investments: proceeds from maturities and pay downs	1,514,538	1,407,514
Available for sale investments: purchases	(2,511,423)	(1,783,666)
Cash (used) provided by investing activities from continuing operations	(627,418)	238,021
Cash flows from financing activities		
Net increase (decrease) in demand and term deposit liabilities	149,243	(730,562)
Net increase in securities sold under agreement to repurchase	109,021	-
Repayment of subordinated capital	(7,946)	(13,875)
Preference Shares repurchased	(5,452)	-
Common Shares repurchased	(8,999)	-
Cash dividends paid on Contingent Value Convertible Preference Shares	-	(3,270)
Cash dividends paid on Preference Shares	(15,989)	(16,000)
Preference Shares guarantee fee paid	(2,000)	(2,000)
Cash provided by (used in) financing activities	217,878	(765,707)
Net effect of exchange rates on cash and cash equivalents	25,446	6,536
Net decrease in cash and cash equivalents	(251,179)	(481,723)
Cash and cash equivalents at beginning of year	1,902,726	2,384,449
Cash and cash equivalents at end of year	1,651,547	1,902,726
Supplemental disclosure of cash flow information		
Cash interest paid	28,620	47,051
Cash income tax paid	1,230	871
Non cash item		
Transfer to Other real estate owned	13,755	27,354

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

Note 1: Nature of Business

The Bank of N.T. Butterfield & Son Limited ("Butterfield", "Bank" or the "Company") is incorporated under the laws of Bermuda and has a banking license under the Bank and Deposit Companies Act, 1999 ("the Act"). Butterfield is regulated by the Bermuda Monetary Authority ("BMA"), which operates in accordance with Basel principles.

Butterfield is a full service community bank and a provider of specialised wealth management services. Services offered include retail, private & corporate banking, treasury, custody, asset management and personal & institutional trust services. The Bank provides such services from six jurisdictions: Bermuda, Cayman, Guernsey, Switzerland, The Bahamas and the United Kingdom. The Bank holds all applicable licenses required in the jurisdictions in which it operates.

Note 2: Significant Accounting Policies

a. Basis of Presentation and Use of Estimates and Assumptions

The accounting and financial reporting policies of the Bank and its subsidiaries conform to generally accepted accounting principles in the United States of America ("GAAP"). The preparation of Consolidated Financial Statements in accordance with GAAP requires Management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements and the reported amounts of revenues and expenses during the year, and actual results could differ from those estimates.

Critical accounting estimates are those that require Management to make subjective or complex judgments about the effect of matters that are inherently uncertain and may change in subsequent periods. Changes that may be required in the underlying assumptions or estimates in these areas could have a material impact on the future financial condition and results of operations. Management believes that the most critical accounting policies upon which the financial condition depends, and which involve the most complex or subjective decisions or assessments, are as follows:

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

b. Basis of Consolidation

The Consolidated Financial Statements include the accounts of the Company and its majority-owned subsidiaries (collectively the "Bank"), and those variable interest entities ("VIEs") where the Company is the primary beneficiary. Intercompany accounts and transactions have been eliminated. The Bank consolidates subsidiaries where it holds, directly or indirectly, more than 50% of the voting rights or where it exercises control. The Bank consolidates VIEs where it is considered to be the primary beneficiary. The Bank is deemed to have a controlling financial interest and is the primary beneficiary of a VIE if it has both the power to direct the activities of the VIE that most significantly impacts the VIE economic performance and an obligation to absorb losses or the right to receive benefits that could potentially be significant to the VIE. The determination of whether the Bank meets the criteria to be considered the primary beneficiary of a VIE requires a periodic evaluation of all transactions (such as investments, loans and fee arrangements) with the entity. Entities where the Bank holds 20% to 50% of the voting rights and/or has the ability to exercise significant influence, other than investments in designated VIEs, are accounted for under the equity method, and the pro rata share of their income (loss) is included in other non-interest income.

c. Foreign Currency Translation

Assets, liabilities, revenues and expenses denominated in US dollars are translated to Bermuda dollars at par. Assets and liabilities of the parent company arising from other foreign currency transactions are translated into Bermuda dollars at the rates of exchange prevailing at the Balance Sheet date. The resulting gains or losses are included in foreign exchange revenue in the Consolidated Statement of Operations.

The assets and liabilities of foreign currency-based subsidiaries are translated at the rate of exchange prevailing on the Balance Sheet date, while associated revenues and expenses are translated to Bermuda dollars at the average rates of exchange prevailing throughout the year. Unrealised translation gains or losses on investments in foreign currency- based subsidiaries are recorded as a separate component of Shareholders' equity within accumulated other comprehensive income (loss) ("AOCI"). Gains and losses on foreign currency based subsidiaries are recorded in the Consolidated Statement of Operations only when realised.

d. Assets Held in Trust or Custody

Securities and properties (other than cash and deposits held with the Bank and its subsidiaries) held in trust, custody, agency or fiduciary capacity for customers are not included in the Consolidated Balance Sheet because the Bank is not the beneficiary of these assets.

e. Cash and Cash Equivalents

Cash and cash equivalents include cash on hand, cash items in the process of collection, amounts due from correspondent banks and highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in fair value. Such investments are those with less than three months' maturity from the date of acquisition and include unrestricted term deposits, certificates of deposit and Treasury bills.

f. Short-Term Investments

Short-term investments comprise restricted term and demand deposits and unrestricted term deposits and Treasury bills with less than one year but greater than three months' maturity from the date of acquisition.

Note 2: Significant Accounting Policies (continued)

g. Investments

Investments in debt and equity securities are classified as trading, available for sale ("AFS") or held to maturity ("HTM").

Investments are classified primarily as AFS when used to manage the Bank's exposure to interest rate and liquidity movements, as well as to make strategic longer-term investments. AFS investments are carried at fair value in the Consolidated Balance Sheet with unrealised gains and losses reported as net increase or decrease to AOCI. Debt and equity securities classified as trading investments are carried at fair value in the Consolidated Balance Sheet, with unrealised gains and losses included in the Consolidated Statement of Operations as net realised / unrealised gains (losses) on trading investments.

Investments that the Bank has the positive intent and ability to hold to maturity are classified as HTM and are carried at amortised cost in the Consolidated Balance Sheet. Unrecognised gains and losses on HTM securities are disclosed in the notes to the Consolidated Financial Statements. The specific identification method is used to determine realised gains and losses on AFS and HTM investments, which are included in net realised gains and losses on AFS and HTM investments respectively in the Consolidated Statement of Operations.

Dividend and interest income, including amortisation of premiums and discounts, on securities for which cash flows are not considered uncertain are included in interest income in the Consolidated Statement of Operations. For securities with uncertain cash flows, the investments are accounted for under the cost recovery method, whereby all principal and coupon payments received are applied as a reduction of the amortised cost and carrying amount. Accrual of income is suspended in respect of debt securities that are in default, or from which it is unlikely that future interest payments will be received as scheduled.

Contained within other assets are investments in a closed ended fund and private equity companies for which the Bank does not have sufficient rights or ownership interests to follow the equity method of accounting. With respect to the closed ended fund, the Bank uses the net assets value as a practical expedient for fair value. Unquoted equity investments which are held directly by the Bank and which do not have readily determinable fair values are recorded at cost and reviewed for impairment if indicators of impairment exist.

Investments in affiliates includes investments whereby the Bank has the ability to influence, but not control, the financial or operating policies of such entities, are accounted for using the equity method of accounting.

Recognition of other-than-temporary impairments

For debt securities, management considers a decline in fair value to be other-than-temporary when it does not expect to recover the entire amortised cost basis of the security. Investments in debt securities in unrealised loss positions are analysed as part of Management's ongoing assessment of other-than-temporary impairment ("OTTI"). When management intends to sell such securities or it is more likely than not that the Bank will be required to sell the securities before recovering the amortised cost, it recognises an impairment loss equal to the full difference between the amortised cost basis and the fair value of those securities. When management does not intend to sell or it is not more likely than not that the Bank will be required to sell such securities before recovering the amortised cost, Management determines whether any credit losses exist to identify any OTTI. Under certain circumstances, Management will perform a qualitative determination and consider a variety of factors, including the length of time and extent to which the fair value has been less than cost; adverse conditions specifically related to the industry, geographic area or financial condition of the issuer or underlying collateral of a security; payment structure of the security; changes to the rating of the security by a rating agency; the volatility of the fair value changes; and changes in fair value of the security after the Balance Sheet date. Alternatively, Management estimates cash flows over the remaining lives of the underlying security to assess whether credit losses exist. In situations where there is a credit loss, only the amount of impairment relating to credit losses on AFS and HTM investments is recognised in net income and for AFS investments, the decrease in fair value relating to factors other than credit losses are recognised in AOCI. Cash flow estimates take into account expectations of relevant market and economic data as of the end of the reporting period, including, for example, underlying loan-level data, and structural features of securitisation, such as subordination, excess spread, over collateralisation or other forms of credit enhancement. The degree of judgment involved in determining the recoverable value of an investment security is dependent upon the availability of observable market prices or observable market parameters. When observable market prices and parameters do not exist, judgment is necessary to estimate recoverable value which gives rise to added uncertainty in the assessment. The assessment takes into consideration factors such as interest rate changes, movements in credit spreads, default rate assumptions, prepayment assumptions, type and quality of collateral, and market sentiment.

With respect to the Pass-through note investment ("PTN"), Management compares cash flow projections to fair value and amortised cost to determine if any credit losses exist. Management's cash flow forecasts for the PTN were created in conjunction with a specialist in analytical cash flow modelling. Management also performs other analyses to support its cash flow projections to assess the reasonability.

Management's fair valuations may include inputs and assumptions that are less observable or require greater estimation, thereby resulting in values which may be greater or lower than the actual value at which the investments may be ultimately sold or the ultimate cash flows that may be recovered. If the assumptions on which Management based its fair valuations change, the Bank may experience additional OTTI or realised losses or gains, and the period-to-period changes in value could vary significantly.

h. Loans

Loans are reported as the principal amount outstanding, net of allowance for credit losses, unearned income and net deferred loan fees. Interest income is recognised over the term of the loan using the effective interest method, or on a basis approximating a level rate of return over the term of the loan, except for loans classified as non-accrual.

Impaired loans

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-accruing loans and all loans modified in a troubled debt restructuring (''TDR'') even if full collectability is expected following the restructuring.

When a loan is identified as impaired, the impairment is measured based on the present value of expected future cash flows, discounted at the loan's effective interest rate, except when the sole (remaining) source of repayment for the loan is the operation or liquidation of the collateral. In these cases the current fair value of the collateral, less selling costs, is used instead of discounted cash flows.

If the Bank determines that the expected realisable value of the impaired loan is less than the recorded investment in the loan (net of previous charge-offs, deferred loan fees or costs and unamortised premium or discount), impairment is recognised through an allowance estimate. If the Bank determines that part of the allowance is uncollectible, that amount is charged off.

Note 2: Significant Accounting Policies (continued)

Non-accrual

Commercial, commercial real estate and consumer loans (excluding credit card consumer loans) are placed on non-accrual status generally if:

- in the opinion of Management, full payment of principal or interest is in doubt; or
- principal or interest is 90 days past due.

Residential mortgages are placed on non-accrual status immediately if:

- in the opinion of Management, full payment of principal or interest is in doubt; or
- when principal or interest is 90 days past due, unless the loan is well secured and any ongoing collection efforts are reasonably expected to result in repayment of all amounts due under the contractual terms of the loan.

Interest income on non-accrual loans is recognised only to the extent it is received in cash. Cash received on non-accrual loans where there is no doubt regarding full repayment (no impairment recognised in the form of a specific allowance) is first applied as repayment of the past due principal amount of the loan and secondly to past due interest and fees.

Where there is doubt regarding the ultimate full repayment of the non-accrual loan (impairment recognised in the form of a specific allowance), all cash received is applied to reduce the principal amount of the loan. Interest income on these loans is recognised only after the entire balance receivable is recovered and interest is actually received.

Loans are restored to accrual status only when interest and principal payments are brought current and future payments are reasonably assured.

Loans Modified in a Troubled Debt Restructuring

A modification of a loan constitutes a troubled debt restructuring ("TDR") when a borrower is experiencing financial difficulty and the modification constitutes a concession. If a restructuring is considered a TDR, the Bank is required to make certain disclosures in the notes of the Consolidated Financial Statements and individually evaluate the restructured loan for impairment. The Bank employs various types of concessions when modifying a loan that it would not otherwise consider which may include extension of repayment periods, interest rate reductions, principal or interest forgiveness, forbearance, and other actions intended to minimise economic loss and to avoid foreclosure or repossession of collateral.

Commercial and industrial loans modified in a TDR often involve temporary interest-only payments, term extensions, and converting revolving credit lines to term loans. Additional collateral, a co-borrower, or a guarantor is often requested.

Commercial mortgage and construction loans modified in a TDR often involve extending the maturity date at an interest rate lower than the current market rate for new debt with similar risk, or substituting or adding a new borrower or guarantor.

Construction loans modified in a TDR may also involve extending the interest-only payment period.

Residential mortgage modifications generally involve a short-term forbearance period after which the missed payments are added to the end of the loan term, thereby extending the maturity date. Interest continues to accrue on the missed payments and as a result, the effective yield on the mortgage remains unchanged. As the forbearance period usually involves an insignificant payment delay they typically do not meet the reporting criteria for a TDR.

Automobile loans modified in a TDR are primarily comprised of loans where the Bank has lowered monthly payments by extending the term.

Loans modified in a TDR are typically already on non-accrual status and partial charge-offs have in some cases already been taken against the outstanding loan balance.

Loans that have been modified in a TDR are restored to accrual status only when interest and principal payments are brought current for a continuous period of six months under the modified terms. However, performance prior to the modification, or significant events that coincide with the modification, are included in assessing whether the borrower can meet the new terms and may result in the loan being returned to accrual status at the time of loan modification or after a shorter performance period. If the borrower's ability to meet the revised payment schedule is uncertain, the loan remains on non-accrual status.

A loan that is modified in a TDR prior to becoming impaired will be left on accrual status if full collectability in accordance with the restructured terms is expected. The Bank works with its customers in these difficult economic times and may enter into a TDR for loans that are in default, or at risk of defaulting, even if the loan is not impaired.

Delinquencies

The entire balance of an account is contractually delinquent if the minimum payment of principal or interest is not received by the specified due date. Delinquency is reported on loans that are 30 days or more past due.

Charge offs

The Bank recognises charge offs when it determines that loans are uncollectible and this generally occurs when all commercially reasonable means of recovering the loan balance have been exhausted.

Commercial and consumer loans are either fully or partially charged off down to the fair value of collateral securing the loans when:

- Management judges the loan to be uncollectible;
- repayment is expected to be protracted beyond reasonable time frames;
- the asset has been classified as a loss by either the Bank's internal loan review process or external examiners; or
- the customer has filed bankruptcy and the loss becomes evident owing to a lack of assets or cash flow.

The outstanding balance of commercial and consumer real estate secured loans and residential mortgages that are in excess of the estimated property value, less costs to sell, is charged off once there is reasonable assurance that such excess outstanding balance is not recoverable.

Note 2: Significant Accounting Policies (continued)

Credit card consumer loans that are contractually 180 days past due and other consumer loans with an outstanding balance under $100,000 that are contractually 180 days past due are written off and reported as charge-offs.

i. Allowance for Credit Losses

The Bank maintains an allowance for credit losses, which in Management's opinion is adequate to absorb all estimated credit related losses in its lending and off-Balance Sheet credit-related arrangements at the Balance Sheet date. The allowance for credit losses consists of specific allowances and a general allowance as follows:

Specific Allowances

Specific allowances are determined on an exposure by exposure basis and reflect the associated estimated credit loss. The specific allowance for credit loss is computed as the difference between the recorded investment in the loan and the present value of expected future cash flows from the loan. The effective rate of return on the loan is used for discounting the cash flows. However, when foreclosure of a collateral-dependent loan is probable, the Bank measures impairment based on the fair value of the collateral. The Bank considers estimated costs to sell, on a discounted basis, in the measurement of impairment if those costs are expected to reduce the cash flows available to repay or otherwise satisfy the loan. If the measurement of an impaired loan is less than the recorded investment in the loan, then the Bank recognises impairment by creating an allowance with a corresponding charge to provision for credit losses.

General Allowance

The allowance for credit losses attributed to the remaining portfolio is established through various analyses that estimate the incurred loss at the Balance Sheet date inherent in the lending and off-Balance Sheet credit-related arrangements portfolios. These analyses consider historical default rates and loss severities, internal risk ratings, and geographic, industry, and other environmental factors. Management also considers overall portfolio indicators including trends in internally risk rated exposures, cash-basis loans, historical and forecasted write offs, and a review of industry, geographic and portfolio concentrations, including current developments within those segments. In addition, Management considers the current business strategy and credit process, including limit setting and compliance, credit approvals, loan underwriting criteria and loan workout procedures.

Each portfolio of smaller balance, homogeneous loans, including consumer instalment, revolving credit, and most other consumer loans, is collectively evaluated for impairment. The allowance for credit losses attributed to these loans is established via a process that estimates the probable losses inherent and incurred in the portfolio, based upon various analyses. Management considers overall portfolio indicators including historical credit losses; delinquent (defined as loans that are more than 30 days past due), non-performing, and classified loans; trends in volumes and terms of loans; an evaluation of overall credit quality; the credit process, including lending policies and procedures; and economic, geographical, product, and other environmental factors.

j. Business Combinations, Goodwill and Intangible Assets

All business combinations are accounted for using the purchase method. Identifiable intangible assets (mostly customer relationships) are recognised separately from goodwill and are initially valued using discounted cash flow calculations and other recognised valuation techniques. Goodwill represents the excess of the price paid for the acquisition of a business over the fair value of the net assets acquired.

Goodwill is tested annually for impairment at the reporting unit level, or more frequently if events or circumstances indicate there may be impairment. If the carrying amount of a reporting unit, including the allocated goodwill, exceeds its fair value, goodwill impairment is measured as the excess of the carrying amount of the reporting unit's allocated goodwill over the implied fair value of the goodwill. Other acquired intangible assets with finite lives are amortised on a straight-line basis over their estimated useful lives, not exceeding 15 years. Intangible assets' estimated lives are re-evaluated annually and an impairment test is carried out if certain indicators of impairment exist.

k. Premises, Equipment and Computer Software

Land, buildings, equipment and computer software, including leasehold improvements, are carried at cost less accumulated depreciation. The Bank generally computes depreciation using the straight-line method over the estimated useful life of an asset, which is 50 years for buildings, and 3 to 10 years for other equipment. For leasehold improvements the Bank uses the straight-line method over the lesser of the remaining term of the leased facility or the estimated economic life of the improvement. The Bank capitalises certain costs, including interest cost incurred during the development phase, associated with the acquisition or development of internal use software. Once the software is ready for its intended use, these costs are amortised on a straight-line basis over the software's expected useful life, which is between 5 and 10 years.

Management reviews the recoverability of the carrying amount of premises, equipment and computer software when indicators of impairment exist and an impairment charge is recorded when the carrying amount of the reviewed asset is deemed not recoverable by future expected cash flows to be derived from the use and disposition of the asset.

l. Other Real Estate Owned

Other real estate owned ("OREO") is comprised of real estate property held for sale and commercial and residential real estate properties acquired in partial or total satisfaction of loans acquired through foreclosure proceedings, acceptance of a deed-in-lieu of foreclosure or by taking possession of assets that were used as loan collateral. These properties are recorded at fair value less estimated costs to sell the property. If the recorded investment in the loan exceeds the property's fair value at the time of acquisition, a charge-off is recorded against the specific allowance. If the carrying value of the real estate exceeds the property's fair value at the time of reclassification, an impairment charge is recorded in the Consolidated Statement of Operations. Subsequent decreases in the property's fair value and operating expenses of the property are recognised through charges to non-interest expense.

m. Derivatives

All derivatives are recognised on the Consolidated Balance Sheet at their fair value. On the date that the Bank enters into a derivative contract, it designates the derivative as: a hedge of the fair value of a recognised asset or liability (a fair value hedge); a hedge of a forecasted transaction or the variability of cash flows that are to be received or paid in connection with a recognised asset or liability (a cash flow hedge); or an instrument that is held for trading or non-hedging purposes (a trading or non-hedging instrument).

The changes in the fair value of a derivative that is designated and qualifies as a fair value hedge, along with changes in the fair value of the hedged asset or liability that are attributable to the hedged risk, are recorded in current year earnings. When the hedge is highly effective, the changes in the fair value of a derivative that is designated and qualifies as a cash flow hedge, to the extent that the hedge is effective, are recorded in other comprehensive income, until earnings are affected by the variability of cash flows of the hedged transaction. Any hedge ineffectiveness is recorded in current year earnings.

Note 2: Significant Accounting Policies (continued)

The changes in the fair value of a derivative that is designated and qualifies as a foreign currency hedge is recorded in either current year earnings or other comprehensive income, depending on whether the hedging relationship satisfies the criteria for a fair value or cash flow hedge when the hedge is highly effective. If, however, a derivative is used as a hedge of a net investment in a foreign operation, the changes in the derivative's fair value, to the extent that the derivative is effective as a hedge, are recorded in the cumulative translation adjustment account within other comprehensive income. Changes in the fair value of derivative trading and non-hedging instruments are reported in current year earnings.

The Bank formally documents all relationships between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. This process includes linking all derivatives that are designated as fair value, cash flow, or foreign currency hedges to specific assets and liabilities on the Consolidated Balance Sheet or specific firm commitments or forecasted transactions. The Bank also formally assesses whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the fair value or cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods. When it is determined that a derivative has ceased to be highly effective as a hedge, the Bank discontinues hedge accounting prospectively.

For those hedge relationships that are terminated, hedge designations that are removed, or forecasted transactions that are no longer expected to occur, the hedge accounting treatment described in the paragraphs above is no longer applied and the end-user derivative is terminated or transferred to the trading account. For fair value hedges, any changes to the hedged item remain as part of the basis of the asset or liability and are ultimately reflected as an element of the yield. For cash flow hedges, any changes in fair value of the end-user derivative remain in other comprehensive income and are included in retained earnings of future periods when earnings are also affected by the variability of the hedged cash flows. If the forecasted transaction is no longer likely to occur, any changes in fair value of the end-user derivatives are recognised in net income.

n. Securities Sold Under Agreements to Repurchase

Securities sold under agreements to repurchase (securities financing agreements) are treated as collateralised financing transactions. The obligation to repurchase is recorded at the value of the cash received on sale adjusted for the amortisation of the difference between the sale price and the agreed repurchase price. The amortisation of this amount is recorded as an interest expense.

o. Collateral

We pledge assets as collateral as required for various transactions involving security repurchase agreements, deposit products and derivative financial instruments. Assets that have been pledged as collateral, including those that can be sold or repledged by the secured party, continue to be reported on the Bank's Consolidated Balance Sheet.

p. Employee Future Benefits

The Bank maintains trusteed pension plans for substantially all employees as either non-contributory defined benefit plans or defined contribution plans. Benefits under the defined benefit plans are primarily based on the employee's years of credited service and average annual salary during the final years of employment as defined in the plans. The Bank also provides post-retirement medical benefits for certain qualifying active and retired Bermuda-based employees.

Expense for the defined benefit pension plans and the post-retirement medical benefits plan is comprised of (a) the actuarially determined benefits for the current year's service, (b) imputed interest on the actuarially determined liability of the plan, (c) in the case of the defined benefit pension plans, the expected investment return on the fair value of plan assets and (d) amortisation of certain items over the expected average remaining service life of employees in the case of the active defined benefit pension plans, estimated average remaining life expectancy of the inactive participants in the case of the inactive defined benefit pension plans and the expected average remaining service life to full eligibility age of employees covered by the plan in the case of the post-retirement medical benefits plan. The items amortised are amounts arising as a result of experienced gains and losses, changes in assumptions, plan amendments and the change in the net pension asset or post-retirement medical benefits liability arising on adoption of revised accounting standards.

For each of the defined benefit pension plans and for the post-retirement medical benefits plan, the asset (liability) recognised for accounting purposes is reported in other assets and employee future benefits respectively. The actuarial gains and losses, transition obligation and past service costs of the defined pension plans and post-retirement medical benefits plan are recognised in OCI net of tax and amortised to net income over the average service period for the active defined benefit pension plans and post-retirement medical benefits plan and average remaining life expectancy for the inactive defined benefit pension plans.

For the defined contribution pension plans the Bank and participating employees provide an annual contribution based on each participating employee's pensionable earnings. Amounts paid are expensed in the period.

q. Share-Based Compensation

The Bank engages in equity settled Share-based payment transactions in respect of services received from eligible employees. The fair value of the services received is measured by reference to the fair value of the Shares or Share options granted on the date of the grant. The cost of the employee services received in respect of the Shares or Share options granted is recognised in the Consolidated Statement of Operations over the shorter of the vesting or service period.

The fair value of the options granted is determined using option pricing models, which take into account the exercise price of the option, the current Share price, the risk-free interest rate, expected dividend rate, the expected volatility of the Share price over the life of the option and other relevant factors. Time vesting conditions are taken into account by adjusting the number of Shares or Share options included in the measurement of the cost of employee services so that ultimately, the amount recognised in the Consolidated Statement of Operations reflects the number of vested Shares or Share options. The Bank recognises compensation cost for awards with performance conditions if and when the Bank concludes that it is probable that the performance condition will be achieved, net of an estimate of pre-vesting forfeitures (e.g., due to termination of employment prior to vesting).

Note 2: Significant Accounting Policies (continued)

r. Revenue Recognition

Trust and investment services fees include fees for private and institutional trust, executorship, and custody services. Asset management fees include fees for investment management, investment advice and brokerage services. Fees are recognised as revenue over the period of the relationship or when the Bank has rendered all services to the clients and is entitled to collect the fee from the client, as long as there are no contingencies associated with the fee.

Banking services fees primarily include fees for certain loan origination, letters of credit, other financial guarantees, compensating balances and other financial services-related products. Certain loan origination fees are primarily overdraft and other revolving lines of credit fees. These fees are recognised as revenue over the period of the underlying facilities. Letters of credit fees are recognised as revenue over the period in which the related service is provided. All other fees are recognised as revenue in the period in which the service is provided.

Loan interest income includes the amortisation of non-refundable loan origination and commitment fees. These fees are deferred (except for certain retrospectively determined fees meeting specified criteria) and recognised as an adjustment of yield over the life of the related loan. These loan origination and commitment fees are offset by their related direct cost and only the net amounts are deferred and amortised into interest income.

Dividend and interest income, including amortisation of premiums and discounts, on securities for which cash flows are not considered uncertain are included in interest income in the Consolidated Statement of Operations. Loans placed on non-accrual status and investments with uncertain cash flows are accounted for under the cost recovery method, whereby all principal, dividends, interest and coupon payments received are applied as a reduction of the amortised cost and carrying amount.

s. Fair Values

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Bank determines the fair values of assets and liabilities based on the fair value hierarchy which requires an entity to maximise the use of observable inputs and minimise the use of unobservable inputs when measuring fair value. The relevant accounting standard describes three levels of inputs that may be used to measure fair value. Investments classified as trading and available for sale, and derivative assets and liabilities are recognised in the Consolidated Balance Sheet at fair value.

Level 1, 2 and 3 valuation inputs

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 as described below.

Fair value inputs are considered Level 1 when based on unadjusted quoted prices in active markets for identical assets.

Fair value inputs are considered Level 2 when based on internally developed models or based on prices published by independent pricing services using proprietary models. To qualify for Level 2, all significant inputs used in these models must be observable in the market place or can be corroborated by observable market data for substantially the full term of the instrument and includes, among others: interest yield curves, credit spreads, prices for similar assets and foreign exchange rates. Level 2 also includes financial instruments that are valued using quoted price for identical assets but for which the market is not considered active due to low trading volumes.

Fair value inputs are considered Level 3 when based on internally developed models using significant unobservable assumptions involving Management's estimations or non-binding bid quotes from brokers.

The following methods and assumptions were used in the determination of the fair value of financial instruments:

Cash and cash equivalents

The carrying amount of cash and demand deposits with banks, being short-term in nature, is deemed to equate to the fair value.

Cash equivalents include unrestricted term deposits, certificates of deposits and Treasury bills with a maturity of less than three months from the date of acquisition and the carrying value at cost is considered to approximate fair value because they are short-term in nature, bear interest rates that approximate market rates, and generally have negligible credit risk.

Short-term investments

Short-term investments comprise restricted term and demand deposits and unrestricted term deposits and Treasury bills with less than one year but greater than three months' maturity from the date of acquisition. The carrying value at cost is considered to approximate fair value because they are short-term in nature, bear interest rates that approximate market rates, and generally have negligible credit risk.

Trading investments including defined benefit pension plan equity securities and mutual funds

Trading investments include mutual funds and debt securities issued by non-US governments. The fair value of listed equity securities is based upon quoted market values. Investments in actively traded mutual funds are based on their published net asset values. See "Available for sale and held to maturity investments including defined benefit pension plan fixed income securities" below for valuation techniques and inputs of fixed income securities.

Note 2: Significant Accounting Policies (continued)

Available for sale and held to maturity investments including defined benefit pension plan fixed income securities

The fair values for available for sale investments are generally sourced from third parties. The fair value of fixed income securities is based upon quoted market values where available, "evaluated bid" prices provided by third party pricing services ("pricing services") where quoted market values are not available, or by reference to broker or underwriter bid indications where pricing services do not provide coverage for a particular security. To the extent the Bank believes current trading conditions represent distressed transactions, the Bank may elect to utilise internally generated models. The pricing services use market approaches for valuations using primarily Level 2 inputs (in the vast majority of valuations), or some form of discounted cash flow analysis, to obtain investment values for a small percentage of fixed income securities. Pricing services indicate that they will only produce an estimate of fair value if there is objectively verifiable information available to produce a valuation. Standard inputs to the valuations provided by the pricing services listed in approximate order of priority for use when available include: reported trades, benchmark yields, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, and reference data. The pricing services may prioritise inputs differently on any given day for any security, and not all inputs listed are available for use in the evaluation process on any given day for each security evaluation; however, the pricing services also monitor market indicators and industry and economic events. Information of this nature is a trigger to acquire further corroborating market data. When these inputs are not available, they identify "buckets" of similar securities (allocated by asset class types, sectors, sub-sectors, contractual cash flows/structure, and credit rating characteristics) and apply some form of matrix or other modeled pricing to determine an appropriate security value which represents their best estimate as to what a buyer in the marketplace would pay for a security in a current sale. While the Bank receives values for the majority of the investment securities it holds from pricing services, it is ultimately Management's responsibility to determine whether the values received and recorded in the financial statements are representative of appropriate fair value measurements. It is common industry practice to utilise pricing services as a source for determining the fair values of investments where the pricing services are able to obtain sufficient market corroborating information to allow them to produce a valuation at a reporting date. In addition, in the majority of cases, although a value may be obtained from a particular pricing service for a security or class of similar securities, these values are corroborated against values provided by other pricing services.

Broker/dealer quotations are used to value fixed maturities where prices are unavailable from pricing services due to factors specific to the security such as limited liquidity, lack of current transactions, or trades only taking place in privately negotiated transactions. These are considered Level 3 valuations, as significant inputs utilised by brokers may be difficult to corroborate with observable market data, or sufficient information regarding the specific inputs utilised by the broker was not available to support a Level 2 classification.

For disclosure purposes, investments held to maturity are fair valued using the same methods described above.

Loans

The majority of loans are variable rate and re-price in response to changes in market rates and hence Management estimates that the fair value of loans is not significantly different than their carrying amount. For significant fixed-rate loan exposures fair value is estimated by discounting the future cash flows, using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities, of such loans.

Accrued interest

The carrying amounts of accrued interest receivable and payable are assumed to approximate their fair values given their short-term nature.

Other real estate owned

OREO assets are carried at the lower of cost or fair value less estimated costs to sell. Fair value is based on third-party appraisals adjusted to reflect Management's judgment as to the realisable value of the properties. Appraisals of OREO properties are updated on an annual basis.

Deposits

The fair value of fixed-rate deposits has been estimated by discounting the contractual cash flows, using market interest rates offered at the Balance Sheet date for deposits of similar terms. The carrying amount of deposits with no stated maturity date is deemed to equate to the fair value.

Subordinated capital

The fair value of the subordinated capital has been estimated by discounting the contractual cash flows, using current market interest rates.

Derivatives

Derivative contracts can be exchange traded or Over-the-counter ("OTC") derivative contracts and may include forward, swap and option contracts relating to interest rates or foreign currencies. Exchange-traded derivatives typically fall within Level 1 of the fair value hierarchy depending on whether they are deemed to be actively traded or not. OTC derivatives are valued using market transactions and other market evidence whenever possible, including market-based inputs to models, model calibration to market clearing transactions, broker or dealer quotations or alternative pricing sources where an understanding of the inputs utilised in arriving at the valuations is obtained. Where models are used, the selection of a particular model to value an OTC derivative depends upon the contractual terms and specific risks inherent in the instrument as well as the availability of pricing information in the market. The Bank generally uses similar models to value similar instruments. Valuation models require a variety of inputs, including contractual terms, market prices, yield curves, credit curves, measures of volatility, prepayment rates and correlations of such inputs. For OTC derivatives that trade in liquid markets, such as generic forwards, interest rate swaps and options, model inputs can generally be verified and model selection does not involve significant Management judgment.

Reporting units

The fair value of reporting units for which goodwill is recognised is determined by discounting estimated future cash flows using discount rates reflecting valuation-date market conditions and risks specific to the reporting unit.

Note 2: Significant Accounting Policies (continued)

t. Credit-Related Arrangements

In the normal course of business, the Bank enters into various commitments to meet the credit requirements of its customers. Such commitments, which are not included in the Consolidated Balance Sheet, include:

- Commitments to extend credit which represent undertakings to make credit available in the form of loans or other financing for specific amounts and maturities, subject to certain conditions.
- Standby letters of credit, which represent irrevocable obligations to make payments to third parties in the event that the customer is unable to meet its financial obligations.
- Documentary and commercial letters of credit, primarily related to the import of goods by customers, which represent agreements to honour drafts presented by third parties upon completion of specific activities.

These credit arrangements are subject to the Bank's normal credit standards and collateral is obtained where appropriate. The contractual amounts for these commitments set out in the table in Note 13 represent the maximum payments the Bank would have to make should the contracts be fully drawn, the counterparty default, and any collateral held prove to be of no value. As many of these arrangements will expire or terminate without being drawn upon or are fully collateralised, the contractual amounts do not necessarily represent future cash requirements. The Bank does not carry any liability for these obligations.

u. Income Taxes

The Bank uses the asset and liability method of accounting for income taxes. Under this method, deferred income taxes reflect the net tax effect of temporary differences between the Consolidated Financial Statements' carrying amounts of assets and liabilities and their respective tax bases. Accordingly, a deferred income tax asset or liability is determined for each temporary difference based on the enacted tax rates to be in effect on the expected reversal date of the temporary difference. The effect of a change in tax rates on deferred tax assets and liabilities is recognised in income in the period that includes the enactment date.

The Bank record net deferred tax assets to the extent the Bank believe these assets will more likely than not be realised. Net deferred income tax assets or liabilities accumulated as a result of temporary differences are included in other assets or other liabilities, respectively. A valuation allowance is established to reduce deferred income tax assets to the amount more likely than not to be realised. In making such a determination, the Bank considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax-planning strategies, and results of recent operations. In the event the Bank were to determine that the Bank would be able to realise the deferred income tax assets in the future in excess of their net recorded amount, the Bank would make an adjustment to the deferred tax asset valuation allowance, which would reduce the provision for income taxes. The Bank records uncertain tax positions on the basis of a two-step process whereby (1) the Bank determines whether it is more likely than not that the tax positions will be sustained based on the technical merits of the position and (2) where those tax positions that meet the more-likely-than-not recognition threshold, the Bank recognises the largest amount of tax benefit that is greater than 50 percent likely to be realised upon ultimate settlement with the related tax authority.

Income taxes on the Consolidated Statement of Operations include the current and deferred portions of the income taxes. The Bank recognises interest accrued and penalties related to unrecognised tax benefits in operating expenses. Income taxes applicable to items charged or credited directly to Shareholders' equity are included in such items.

v. Consolidated Statement of Cash Flows

For the purposes of the Consolidated Statement of Cash Flows, cash and cash equivalents include cash on hand, cash items in the process of collection, amounts due from correspondent banks and highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in fair value.

w. Earnings Per Share

Earnings per Share have been calculated using the weighted average number of Common Shares outstanding during the year (see also Note 20). Dividends declared on Preference Shares and related guarantee fees are deducted from net income to obtain net income available to Common Shareholders. In periods when basic earnings per Share is positive, the dilutive effect of Share-based compensation plans is 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 Common Shares, using the quarterly average market price of the Bank's Shares for the period.

x. Impairment or Disposal of Long-Lived Assets

Impairment losses are recognised when the carrying amount of a long-lived asset exceeds the sum of the undiscounted cash flows expected from its use and disposal. The impairment recognised is measured as the amount by which the carrying amount of the asset exceeds its fair value. Long-lived assets that are to be disposed of other than by sale are classified and accounted for as held for use until the date of disposal or abandonment. Assets that meet certain criteria are classified as held for sale and are measured at the lower of their carrying amounts or fair value, less costs of sale.

y. Charitable Trust

In July 2000, the Bank established a charitable trust with the irrevocable purpose to make charitable donations to persons ordinarily resident in Bermuda (the "Charitable Trust"). The Charitable Trust came to an end December 2012 when its remaining assets were transferred to various charities in Bermuda. As a not-for-profit organisation, the Charitable Trust is not consolidated in the Bank's Consolidated Financial Statements. As the Charitable Trust's trustees are representatives of the Bank, the Bank's endowment donations to the Charitable Trust are recognised at their recoverable amount in Other assets in the Consolidated Balance Sheet until dispersed by the Charitable Trust, at which time, donations are recognised in Other expenses in the Consolidated Statement of Operations.

Note 2: Significant Accounting Policies (continued)

z. New Accounting Pronouncements

In May 2011, the Financial Accounting Standards Board ("FASB") issued an accounting standards update to amend existing requirements for fair value measurements and disclosures. The guidance expands the disclosure requirements around fair value measurements categorised in Level 3 of the fair value hierarchy, requiring quantitative and qualitative information to be disclosed related to: (1) the valuation processes used, (2) the sensitivity of the fair value measurement to changes in unobservable inputs and the interrelationships between those unobservable inputs, and (3) use of a nonfinancial asset in a way that differs from the asset's highest and best use. The guidance requires disclosure of the level in the fair value hierarchy of items that are not measured at fair value, but whose fair value must be disclosed. It also clarifies and expands upon existing requirements for fair value measurements of financial assets and liabilities, as well as instruments classified in Shareholders' equity. The Bank has applied this guidance from 1 January 2012; however, it impacted disclosure only and did not have an impact on the Bank's financial condition or results of operations.

In June 2011, the FASB issued an accounting standards update concerning the presentation of comprehensive income in financial statements. This guidance allows an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. Under both options, an entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. This guidance eliminates the option to present the components of other comprehensive income only as part of the statement of changes in Shareholders' equity. The guidance does not change the items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income. The Bank applied the guidance from 1 January 2012; however, it did not have an impact on the Bank's disclosure, financial condition or results of operations.

In September 2011, the FASB issued an accounting standards update to simplify how entities test goodwill for impairment, by allowing an entity the option to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting entity is less than its carrying amount, as a basis for determining whether it is necessary to perform the two-step goodwill impairment test required in FASB Accounting Standards Codification Topic 350. After assessing the circumstances that should be considered in making the qualitative assessment, if an entity determines that the fair value of a reporting unit as compared to its carrying value meets the threshold, then performing the two-step impairment step is unnecessary. In other circumstances, performance of the two-step test is required. The guidance also eliminates the option for an entity to carry forward its detailed calculation of a reporting unit's fair value in certain situations. The amendments do not change the current guidance for testing other indefinite-lived intangible assets for impairment. The Bank adopted this guidance beginning on 1 January 2012. It did not have an impact on the Bank's consolidated financial condition or results of operations.

During December 2011, the FASB issued an accounting standard update, "Disclosures about Offsetting Assets and Liabilities". The amendments in this update require an entity to disclose information about offsetting and related arrangements to provide users of the Consolidated Financial Statements with information to understand the extent of offsetting in the statement of financial position. The amendment will allow companies to continue offsetting certain financial instruments on their Balance Sheets, including certain derivatives and repurchase agreements subject to a master netting arrangement. Additionally certain industry-specific offsetting guidance for broker-dealers, construction companies and depository and lending institutions remains unchanged. The disclosure requirements will be effective for periods beginning on or after 1 January 2013, and must be shown for all periods presented on the Balance Sheet (i.e., applied retrospectively). The impact of this additional accounting update is expected to be primarily on disclosures.

(in thousands of Bermuda dollars)

Note 3: Discontinued Operations

On 7 May 2012 the Bank announced its agreement to sell Butterfield Bank (Barbados) Limited, a wholly-owned subsidiary which is all of the 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. The Assets and Liabilities have been presented as discontinued operations on the face of the Consolidated Balance Sheet for all periods presented.

The following summarises the assets and liabilities of Barbados at 31 December 2012 and 2011, which are reported as Assets of discontinued operations and Liabilities of discontinued operations in the Consolidated Balance Sheet.

Assets	**2012**	2011
Cash and cash equivalents	-	76,935
Short- term investments	-	14,534
Investments in debt and equity securities	-	28,088
Loans, net of allowance for credit losses	-	177,841
Premises, equipment and computer software	-	3,643
Accrued interest	-	1,164
Intangible assets	-	3,084
Other assets	-	1,755
Total assets	-	307,044
Liabilities		
Deposits	-	269,083
Accrued interest	-	1,040
Other liabilities	-	1,926
Total liabilities	-	272,049

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

	2012	2011
Non-interest income	**1,701**	2,897
Net interest income	**7,267**	11,485
Provision for credit losses	**(548)**	(1,156)
Revenue before gains (losses)	**8,420**	13,226
Gains (losses)	**249**	37
Total net revenue	**8,669**	13,263
Non-interest expenses	**(7,976)**	(11,862)
Net income before income taxes	**693**	1,401
Gain on sale of discontinued operations	**7,240**	-
Income tax expense	**(313)**	(274)
Net income from discontinued operations	**7,620**	1,127

(in thousands of Bermuda dollars)

Note 4: Cash and Cash Equivalents

	2012			2011		
	Bermuda	Non-Bermuda	Total	Bermuda	Non-Bermuda	Total
Unrestricted						
Non-interest earning						
Cash and demand deposits	172,179	44,425	216,604	176,091	17,823	193,914
Interest earning						
Demand deposits	109,164	150,303	259,467	49	189,864	189,913
Cash equivalents	334,835	840,641	1,175,476	489,391	1,029,508	1,518,899
Sub-total - Interest earning	443,999	990,944	1,434,943	489,440	1,219,372	1,708,812
Total cash and cash equivalents	616,178	1,035,369	1,651,547	665,531	1,237,195	1,902,726

Note 5: Short-term Investments

	2012			2011		
	Bermuda	Non-Bermuda	Total	Bermuda	Non-Bermuda	Total
Unrestricted						
Interest earning						
Term deposits maturing within three months	-	56,727	56,727	-	-	-
Term deposits maturing between three to six months	-	7,672	7,672	-	4,630	4,630
Term deposits maturing between six to twelve months	-	4,761	4,761	-	2,900	2,900
Total unrestricted short-term investments	-	69,160	69,160	-	7,530	7,530
Affected by drawing restrictions related to minimum reserve and derivative margin requirements						
Interest earning						
Demand deposits	6,942	111	7,053	12,641	109	12,750
Total restricted short-term investments	6,942	111	7,053	12,641	109	12,750
Total short-term investments	6,942	69,271	76,213	12,641	7,639	20,280

(in thousands of Bermuda dollars)

Note 6: Investments

Amortised cost, carrying amounts and estimated fair value

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

	2012				2011			
	Amortised cost	**Gross unrealised gains**	**Gross unrealised losses**	**Carrying amount / Fair value**	Amortised cost	Gross unrealised gains	Gross unrealised losses	Carrying amount / Fair value
Trading								
Debt securities issued by non-US governments	**4,301**	**930**	**-**	**5,231**	5,788	419	(236)	5,971
Mutual funds	**56,779**	**511**	**(736)**	**56,554**	56,964	224	(568)	56,620
Total trading	**61,080**	**1,441**	**(736)**	**61,785**	62,752	643	(804)	62,591
Available for sale								
Certificates of deposit	**558,668**	**2,706**	**(14)**	**561,360**	354,847	2,411	(765)	356,493
US government and federal agencies	**1,156,307**	**23,613**	**(1,134)**	**1,178,786**	778,387	14,419	(2,002)	790,804
Debt securities issued by non-US governments	**89,609**	**438**	**(5)**	**90,042**	87,549	1,158	(49)	88,658
Corporate debt securities guaranteed by non-US governments	**32,021**	**5**	**-**	**32,026**	122,987	38	(1,377)	121,648
Corporate debt securities	**400,980**	**20,105**	**-**	**421,085**	408,559	396	(3,706)	405,249
Asset-backed securities - Student loans	**139,304**	**-**	**(3,203)**	**136,101**	149,759	-	(5,413)	144,346
Mortgage backed securities - Commercial	**130,526**	**231**	**(279)**	**130,478**	-	-	-	-
Pass-through note	**30,404**	**242**	**-**	**30,646**	33,696	-	(6,705)	26,991
Equity securities	**126**	**-**	**(73)**	**53**	120	-	(50)	70
Total available for sale	**2,537,945**	**47,340**	**(4,708)**	**2,580,577**	1,935,904	18,422	(20,067)	1,934,259

	2012				2011			
	Amortised cost / Carrying amount	**Gross unrealised gains**	**Gross unrealised losses**	**Fair value**	Amortised cost / Carrying Amount	Gross unrealised gains	Gross unrealised losses	Fair value
Held to maturity [(1)]								
US government and federal agencies	**239,342**	**6,691**	**(1,240)**	**244,793**	64,789	228	(429)	64,588
Total held to maturity	**239,342**	**6,691**	**(1,240)**	**244,793**	64,789	228	(429)	64,588

[(1)] For the years ended 31 December 2012 and 2011 non-credit impairments recognised in AOCI for held to maturity investments was $nil.

Available for sale

As at 31 December 2012, US government and federal agency investment securities classified as Available for sale with an amortised cost of $255.7 million and fair value of $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 $120.9 million and fair market value of $122.4 million were pledged to secure repurchase agreements at 31 December 2012.

Held to maturity

As at 31 December 2012, US government and federal agency investment securities with an amortised cost of $45.7 million were pledged to secure Bank deposit products where the secured party did not have the right to sell or repledge the collateral.

(in thousands of Bermuda dollars)

Note 6: 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.

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	-	-	-	-	-	-
Corporate debt securities	-	-	-	-	-	-
Asset-backed securities - Student loans	-	-	136,101	(3,203)	136,101	(3,203)
Mortgage-backed securities - Commercial	92,306	(279)	-	-	92,306	(279)
Pass-through note	-	-	-	-	-	-
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)

2011	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	48,623	(765)	-	-	48,623	(765)
US government and federal agencies	144,364	(1,585)	72,600	(417)	216,964	(2,002)
Debt securities issued by non-US governments	7,749	(49)	-	-	7,749	(49)
Corporate debt securities guaranteed by non-US governments	30,179	(3)	47,267	(1,374)	77,446	(1,377)
Corporate debt securities	217,612	(2,859)	124,152	(847)	341,764	(3,706)
Asset-backed securities - Student loans	-	-	144,346	(5,413)	144,346	(5,413)
Pass-through note	-	-	26,992	(6,705)	26,992	(6,705)
Equity securities	70	(50)	-	-	70	(50)
Total available-for-sale securities with unrealised losses	448,597	(5,311)	415,357	(14,756)	863,954	(20,067)
Held to maturity						
US government and federal agencies	30,034	(429)	-	-	30,034	(429)
Total held-to-maturity securities with unrealised losses	30,034	(429)	-	-	30,034	(429)

The Bank does not believe that the investment securities that were in an unrealised loss position as of 31 December 2012, which was comprised of 38 securities, or 24% of the portfolio by market value, represent an other-than-temporary impairment. Total gross unrealised losses were only 0.9% of the market value of affected securities and were primarily attributable to changes in 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.

(in thousands of Bermuda dollars)

Note 6: Investments (continued)

The following describes the process for identifying credit impairment in security types with the most significant unrealised losses as of 31 December 2012.

US government and federal agencies

As of 31 December 2012, gross unrealised losses on securities related to United States ("US") government and federal agencies were $1.1 million (2011: $2.0 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 31 December 2012, gross unrealised losses on student loan asset-backed securities were $3.2 million (2011: $5.4 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.

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.

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
Trading							
Debt securities issued by non-US governments	-	1,382	1,157	1,611	1,081	-	5,231
Mutual funds	-	-	-	-	-	56,554	56,554
Total trading	-	1,382	1,157	1,611	1,081	56,554	61,785
Available for sale							
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
Total available-for-sale securities	320,123	324,438	623,115	607,313	705,535	53	2,580,577
Held to maturity							
US government and federal agencies	-	-	-	11,003	228,339	-	239,342
Total held-to-maturity securities	-	-	-	11,003	228,339	-	239,342
Total investments	320,123	325,820	624,272	619,927	934,955	56,607	2,881,704
Total by currency							
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
Total investments	320,123	325,820	624,272	619,927	934,955	56,607	2,881,704

(in thousands of Bermuda dollars)

Note 6: Investments (continued)

2011	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
Trading							
Debt securities issued by non-US governments	-	811	2,026	2,106	1,028	-	5,971
Mutual funds	-	-	-	-	-	56,620	56,620
Total trading	-	811	2,026	2,106	1,028	56,620	62,591
Available for sale							
Certificates of deposit	105,318	174,301	76,874	-	-	-	356,493
US government and federal agencies	-	-	82,444	452,951	255,407	2	790,804
Debt securities issued by non-US governments	7,749	64,057	5,333	11,519	-	-	88,658
Corporate debt securities guaranteed by non-US governments	-	90,882	30,766	-	-	-	121,648
Corporate debt securities	27,514	106,639	257,990	13,106	-	-	405,249
Asset-backed securities - Student loans	-	-	58,183	74,999	11,164	-	144,346
Pass-through note	-	-	-	26,991	-	-	26,991
Equity securities	-	-	-	-	-	70	70
Total available for sale	140,581	435,879	511,590	579,566	266,571	72	1,934,259
Held to maturity							
US government and federal agencies	-	-	-	-	64,789	-	64,789
Total investments	140,581	436,690	513,616	581,672	332,388	56,692	2,061,639
Total by currency							
US dollars	-	181,875	448,777	579,566	331,360	55,407	1,596,985
Other	140,581	254,815	64,839	2,106	1,028	1,285	464,654
Total investments	140,581	436,690	513,616	581,672	332,388	56,692	2,061,639

Sale proceeds and realised gains (losses)

During the twelve months ended 31 December 2012, the Bank disposed of:

- Certificates of deposit totalling $170.1 million in sale proceeds, resulting in a gross realised gain of $0.1 million
- US agency securities totalling $60.4 million in sale proceeds, resulting in gross realised gains of $0.5 million and gross realised losses of $0.1 million;
- Corporate bonds totalling $165.6 million in sale proceeds, resulting in gross realised gains of $1.0 million and gross realised losses of $0.3 million; and
- Other securities totalling $18.2 million in sale proceeds, resulting in a gross realised gain of $0.8 million.

During the year ended 31 December 2011, the Bank disposed of:

- Certificates of deposit totalling $580.2 million in sale proceeds, resulting in a gross realised gain of $0.8 million and a gross realised loss of $0.4 million;
- US agency securities totalling $302.8 million in sale proceeds, resulting in a gross realised gain of $1.8 million; and
- Corporate bonds totalling $88.3 million in sale proceeds, resulting in a gross realised loss of $0.2 million.

(in thousands of Bermuda dollars)

Note 6: Investments (continued)

Gains and losses on investments

The following table presents gains and losses on investments:

Year ended	2012				2011			
	Trading	Available for sale	Held to maturity	Total	Trading	Available for sale	Held to maturity	Total
Gains (losses) other than OTTI recognised in net income	268	2,028	-	2,296	(919)	2,058	-	1,139
Total impairment applied against carrying amount	-	-	-	-	-	-	-	-
Less: change in non-credit related impairments recognised in OCI	-	-	-	-	-	-	-	-
OTTI impairments recognised in net income	-	-	-	-	-	-	-	-
Net gains (losses) recognised in net income	268	2,028	-	2,296	(919)	2,058	-	1,139
Gross unrealised gains recorded in OCI	-	45,146	-	45,146	-	21,903	-	21,903
Realised (gains) losses transferred to net income	-	(2,028)	-	(2,028)	-	(2,058)	-	(2,058)
Total net gains recognised in OCI	-	43,118	-	43,118	-	19,845	-	19,845

(in thousands of Bermuda dollars)

Note 7: Loans

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

	31 December 2012			31 December 2011		
	Bermuda	Non-Bermuda	Total	Bermuda	Non-Bermuda	Total
Commercial loans						
Government	64,534	4,050	68,584	256,442	4,230	260,672
Commercial and industrial	121,947	190,002	311,949	103,922	165,820	269,742
Commercial overdrafts	58,973	22,929	81,902	64,733	25,464	90,197
Total commercial loans	245,454	216,981	462,435	425,097	195,514	620,611
Less specific allowance for credit losses on commercial loans	(166)	(1,250)	(1,416)	(1,222)	(1,250)	(2,472)
Total commercial loans after specific allowance for credit losses	245,288	215,731	461,019	423,875	194,264	618,139
Commercial real estate loans						
Commercial mortgage	495,466	281,456	776,922	502,110	304,525	806,635
Construction	109	2,119	2,228	37,178	2,814	39,992
Total commercial real estate loans	495,575	283,575	779,150	539,288	307,339	846,627
Less specific allowance for credit losses on commercial real estate loans	(8,772)	(4,711)	(13,483)	(9,225)	(2,792)	(12,017)
Total commercial real estate loans after specific allowance for credit losses	486,803	278,864	765,667	530,063	304,547	834,610
Consumer loans						
Automobile financing	19,663	6,050	25,713	23,964	5,862	29,826
Credit card	58,500	15,446	73,946	59,469	13,800	73,269
Overdrafts	8,488	3,933	12,421	9,147	5,359	14,506
Other consumer	66,044	94,819	160,863	87,889	121,298	209,187
Total consumer loans	152,695	120,248	272,943	180,469	146,319	326,788
Less specific allowance for credit losses on consumer loans	(160)	-	(160)	(160)	-	(160)
Total consumer loans after specific allowance for credit losses	152,535	120,248	272,783	180,309	146,319	326,628
Residential mortgage loans	1,351,680	1,145,709	2,497,389	1,348,606	982,278	2,330,884
Less specific allowance for credit losses on residential mortgage loans	(7,743)	(3,930)	(11,673)	(3,184)	(5,637)	(8,821)
Total residential mortgage loans after specific allowance for credit losses	1,343,937	1,141,779	2,485,716	1,345,422	976,641	2,322,063
Total gross loans	2,245,404	1,766,513	4,011,917	2,493,460	1,631,450	4,124,910
Less specific allowance for credit losses	(16,841)	(9,891)	(26,732)	(13,791)	(9,679)	(23,470)
Less general allowance for credit losses	(20,817)	(8,408)	(29,225)	(23,474)	(8,547)	(32,021)
Net loans	2,207,746	1,748,214	3,955,960	2,456,195	1,613,224	4,069,419

The principal means of securing residential mortgages, personal, credit card and business loans are charges over assets and guarantees. Mortgage loans are generally repayable over periods of up to thirty years and personal, credit card, business and government loans are generally repayable over terms not exceeding five years. The effective yield on total loans as at 31 December 2012 was 4.72% (2011: 4.76%).

(in thousands of Bermuda dollars)

Note 7: Loans (continued)

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

The following table summarises the past due status of the loans at 31 December 2012 and 31 December 2011. The aging of past due amounts are determined based on the contractual delinquency status of payments under the loan. An account is generally considered to be contractually delinquent when payments have not been made in accordance with the loan terms.

	2012					
	30 – 59 days	60 – 89 days	90 days or more	Total past due loans	Total Current (1)	Total loans
Commercial loans						
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
Total commercial loans	366	2,247	3,323	5,936	456,499	462,435
Commercial real estate loans						
Commercial mortgage	3,852	1,190	55,584	60,626	716,296	776,922
Construction	-	-	-	-	2,228	2,228
Total commercial real estate loans	3,852	1,190	55,584	60,626	718,524	779,150
Consumer loans						
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
Total consumer loans	2,183	1,271	2,848	6,302	266,641	272,943
Residential mortgage loans	38,334	21,914	69,551	129,799	2,367,590	2,497,389
Total loans	44,735	26,622	131,306	202,663	3,809,254	4,011,917

(1) Loans less than 30 days past due are included in Current.

	2011					
	30 – 59 days	60 – 89 days	90 days or more	Total past due loans	Total Current (1)	Total loans
Commercial loans						
Government	-	-	-	-	260,672	260,672
Commercial and industrial	449	210	2,525	3,184	266,558	269,742
Commercial overdrafts	-	26	4,810	4,836	85,361	90,197
Total commercial loans	449	236	7,335	8,020	612,591	620,611
Commercial real estate loans						
Commercial mortgage	9,866	1,280	45,459	56,605	750,030	806,635
Construction	16,680	1,629	-	18,309	21,683	39,992
Total commercial real estate loans	26,546	2,909	45,459	74,914	771,713	846,627
Consumer loans						
Automobile financing	611	299	633	1,543	28,283	29,826
Credit card (2)	1,719	449	843	3,011	70,258	73,269
Overdrafts	6	9	75	90	14,416	14,506
Other consumer	1,879	548	1,773	4,200	204,987	209,187
Total consumer loans	4,215	1,305	3,324	8,844	317,944	326,788
Residential mortgage loans	63,805	34,350	47,144	145,299	2,185,585	2,330,884
Total loans	95,015	38,800	103,262	237,077	3,887,833	4,124,910

(1) Loans less than 30 days past due are included in Current.

(2) Delinquency for credit cards was previously driven by reporting cycles rather than actual days past payment due date. Commencing in the third quarter delinquency is now consistently measured from the date payment is due. The resultant effect of the clarification of cycle reporting resulted in a disclosure reclassification of $3.9 million from past due credit cards to current credit cards. Prior years have been adjusted to reflect the new measure of delinquency.

(in thousands of Bermuda dollars)

Note 7: Loans (continued)

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

	31 December 2012			31 December 2011		
	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
Commercial loans						
Commercial and industrial	3,606	-	3,606	4,160	-	4,160
Commercial overdrafts	292	9	301	5,683	-	5,683
Total commercial loans	3,898	9	3,907	9,843	-	9,843
Commercial real estate loans	55,167	417	55,584	53,599	8	53,607
Consumer loans						
Automobile financing	581	57	638	983	-	983
Credit cards	-	600	600	-	844	844
Overdrafts	217	10	227	65	11	76
Other consumer	1,984	76	2,060	1,789	173	1,962
Total consumer loans	2,782	743	3,525	2,837	1,028	3,865
Residential mortgage loans	51,506	27,229	78,735	43,828	17,372	61,200
Total loans	113,353	28,398	141,751	110,107	18,408	128,515

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

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

(in thousands of Bermuda dollars)

Note 7: Loans (continued)

31 December 2011	Pass	Special mention	Substandard	Non-accrual	Total gross recorded investments
Commercial loans					
Government	260,672	-	-	-	260,672
Commercial and industrial	253,443	9,732	2,407	4,160	269,742
Commercial overdrafts	81,386	3,128	-	5,683	90,197
Total commercial loans	595,501	12,860	2,407	9,843	620,611
Commercial real estate loans					
Commercial mortgage	608,555	102,705	41,776	53,599	806,635
Construction	38,363	1,629	-	-	39,992
Total commercial real estate loans	646,918	104,334	41,776	53,599	846,627
Consumer loans					
Automobile financing	28,843	-	-	983	29,826
Credit cards	72,314	-	955	-	73,269
Overdrafts	14,369	72	-	65	14,506
Other consumer	199,412	409	7,577	1,789	209,187
Total consumer loans	314,938	481	8,532	2,837	326,788
Residential mortgage loans	2,198,967	45,795	42,294	43,828	2,330,884
Total loans	3,756,324	163,470	95,009	110,107	4,124,910

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:

	2012		2011	
Total gross loans evaluated for impairment	**Individually evaluated**	**Collectively evaluated**	Individually evaluated	Collectively evaluated
Commercial loans	**462,435**	**-**	620,611	-
Commercial real estate loans	**779,150**	**-**	846,627	-
Consumer loans	**2,782**	**270,161**	2,837	323,951
Residential mortgage loans	**59,910**	**2,437,479**	51,210	2,279,674
Total gross loans	**1,304,277**	**2,707,640**	1,521,285	2,603,625

(in thousands of Bermuda dollars)

Note 7: Loans (continued)

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

	31 December 2012					31 December 2011				
	Commercial	**Commercial real estate**	**Consumer**	**Residential mortgage**	**Total**	Commercial	Commercial real estate	Consumer	Residential mortgage	Total
Allowances at beginning of year	**8,336**	**17,888**	**5,735**	**23,532**	**55,491**	7,311	28,046	5,339	21,024	61,720
Provision taken during the year	**(860)**	**7,541**	**1,327**	**6,182**	**14,190**	1,843	1,483	3,958	5,885	13,169
Recoveries	**490**	**-**	**2,953**	**303**	**3,746**	546	634	2,890	13	4,083
Charge-offs	**(1,490)**	**(6,630)**	**(4,678)**	**(4,972)**	**(17,770)**	(1,361)	(12,280)	(6,458)	(3,412)	(23,511)
Other	**120**	**(405)**	**103**	**482**	**300**	(3)	5	6	22	30
Allowances at end of year	**6,596**	**18,394**	**5,440**	**25,527**	**55,957**	8,336	17,888	5,735	23,532	55,491
Ending balance: individually evaluated for impairment	**1,416**	**13,483**	**160**	**11,673**	**26,732**	2,472	12,017	160	8,821	23,470
Ending balance: collectively evaluated for impairment	**5,180**	**4,911**	**5,280**	**13,854**	**29,225**	5,864	5,871	5,575	14,711	32,021

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 year ended 31 December 2012, the amount of gross interest income would have been recorded had impaired loans been current was $7.7 million (2011: $6.9 million). The table below presents information about the Bank's impaired loans:

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**
Commercial loans							
Commercial and industrial	**1,471**	**(1,390)**	**81**	**3,846**	**5,317**	**(1,390)**	**3,927**
Commercial overdrafts	**26**	**(26)**	**-**	**266**	**292**	**(26)**	**266**
Total commercial loans	**1,497**	**(1,416)**	**81**	**4,112**	**5,609**	**(1,416)**	**4,193**
Commercial real estate loans	**52,607**	**(13,483)**	**39,124**	**12,132**	**64,739**	**(13,483)**	**51,256**
Consumer loans							
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**
Total consumer loans	**355**	**(160)**	**195**	**2,427**	**2,782**	**(160)**	**2,622**
Residential mortgage loans	**36,064**	**(11,673)**	**24,391**	**23,846**	**59,910**	**(11,673)**	**48,237**
Total impaired loans	**90,523**	**(26,732)**	**63,791**	**42,517**	**133,040**	**(26,732)**	**106,308**

31 December 2011	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
Commercial loans							
Commercial and industrial	2,164	(1,803)	361	4,844	7,008	(1,803)	5,205
Commercial overdrafts	669	(669)	-	6,056	6,725	(669)	6,056
Total commercial loans	2,833	(2,472)	361	10,900	13,733	(2,472)	11,261
Commercial real estate loans	41,364	(12,017)	29,347	21,937	63,301	(12,017)	51,284
Consumer loans							
Automobile financing	240	(75)	165	743	983	(75)	908
Overdrafts	-	-	-	65	65	-	65
Other consumer	143	(85)	58	1,646	1,789	(85)	1,704
Total consumer loans	383	(160)	223	2,454	2,837	(160)	2,677
Residential mortgage loans	25,483	(8,821)	16,662	25,727	51,210	(8,821)	42,389
Total impaired loans	70,063	(23,470)	46,593	61,018	131,081	(23,470)	107,611

(in thousands of Bermuda dollars)

Note 7: Loans (continued)

The following table presents information about the Bank's average impaired loan balances and interest income recognised for the year ended 31 December 2012 on the impaired loans:

2012	Impaired loans	
	Average recorded investment	Interest income recognised
Commercial loans		
Commercial and industrial	6,163	105
Commercial overdrafts	3,509	-
Total commercial loans	9,672	105
Commercial real estate loans	64,020	523
Consumer loans		
Automobile financing	782	-
Credit cards	-	-
Overdrafts	141	-
Other consumer	1,887	-
Total consumer loans	2,810	-
Residential mortgage loans	55,560	388
Total impaired loans	132,062	1,016

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

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	-	740
Total loans	25	35,914[(1)]	35,877	36,715	-	837

[(1)] The amount is comprised of $16.2 million of non-accrual loans and $19.7 million of loans on accrual status.

31 December 2011					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	4	2,847	2,777	2,777	-	-
Commercial overdrafts	1	1,042	1,142	1,142	-	-
Total commercial loans	5	3,889	3,919	3,919	-	-
Commercial real estate loans	5	22,279	23,121	23,183	-	61
Residential mortgage loans	11	7,382	7,146	7,336	9	180
Total loans	21	33,550[(1)]	34,186	34,438	9	241

[(1)] The amount is comprised of $12.6 million of non-accrual loans and $20.9 million of loans on accrual status.

The Bank had four loans modified in a TDR from 1 January 2012 to 31 December 2012 that subsequently defaulted (i.e., 90 days or more past due following a modification) with a recorded investment amounting to $2.9 million.

(in thousands of Bermuda dollars)

Note 8: 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.

	2012			2011		
	On-balance sheet	**Off-balance sheet**	**Total credit exposure**	On-balance sheet	Off-balance sheet	Total credit exposure
Banks and financial services	**277,273**	**394,858**	**672,131**	330,734	496,753	827,487
Commercial and merchandising	**263,723**	**88,551**	**352,274**	270,089	135,340	405,429
Governments	**58,811**	**28,153**	**86,964**	251,795	-	251,795
Individuals	**2,334,272**	**94,430**	**2,428,702**	2,270,737	93,620	2,364,357
Primary industry and manufacturing	**65,608**	**6,161**	**71,769**	199,979	2,692	202,671
Real estate	**887,178**	**36,523**	**923,701**	675,848	94,029	769,877
Hospitality industry	**90,978**	**-**	**90,978**	92,955	-	92,955
Transport and communication	**7,342**	**-**	**7,342**	9,303	-	9,303
Sub-total	**3,985,185**	**648,676**	**4,633,861**	4,101,440	822,434	4,923,874
General allowance	**(29,225)**	**-**	**(29,225)**	(32,021)	-	(32,021)
Total	**3,955,960**	**648,676**	**4,604,636**	4,069,419	822,434	4,891,853

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

	2012			2011		
	On-balance sheet	**Off-balance sheet**	**Total credit exposure**	On-balance sheet	Off-balance sheet	Total credit exposure
Bermuda	**2,300,661**	**335,184**	**2,635,845**	2,571,607	411,594	2,983,201
Cayman	**547,779**	**194,634**	**742,413**	605,500	172,346	777,846
Guernsey	**534,226**	**72,961**	**607,187**	454,039	149,387	603,426
The Bahamas	**47,883**	**180**	**48,063**	8,972	90	9,062
United Kingdom	**554,636**	**45,717**	**600,353**	461,322	89,017	550,339
Sub-total	**3,985,185**	**648,676**	**4,633,861**	4,101,440	822,434	4,923,874
General allowance	**(29,225)**	**-**	**(29,225)**	(32,021)	-	(32,021)
Total	**3,955,960**	**648,676**	**4,604,636**	4,069,419	822,434	4,891,853

(in thousands of Bermuda dollars)

Note 9: Premises, Equipment and Computer Software

The following table summarises land, buildings, equipment and computer software:

	2012			2011		
	Cost	**Accumulated depreciation**	**Net carrying amount**	Cost	Accumulated depreciation	Net carrying amount
Land	**13,290**	**-**	**13,290**	13,371	-	13,371
Buildings	**154,903**	**(52,109)**	**102,794**	180,006	(50,728)	129,278
Equipment	**47,060**	**(37,552)**	**9,508**	47,987	(37,212)	10,775
Computer software in use	**172,511**	**(63,743)**	**108,768**	166,250	(50,055)	116,195
Computer software in development	**8,961**	**-**	**8,961**	2,853	-	2,853
Total	**396,725**	**(153,404)**	**243,321**	410,467	(137,995)	272,472

	2012	2011
Depreciation		
Buildings (included in property expense)	**6,823**	6,489
Equipment (included in property expense)	**2,735**	2,590
Computer hardware and software (included in technology & communications expense)	**16,194**	9,253
Total depreciation charged to non-interest expense	**25,752**	18,332
Impairment		
Write off of buildings (included in impairment of fixed assets)	**14,527**	-

During 2012, the Bank's intended use for five Bermuda properties changed and therefore the properties were assessed for impairment. The properties are subsequently held for rental income or possible sale and it was determined that the carrying values were not recoverable based on the undiscounted cash flow analysis. The carrying amount of the Bermuda segment's buildings was impaired and was written down by $6.5 million at 31 December 2012 because their respective fair values were lower than the carrying amounts. The fair values of the properties were calculated based on the market approach and, where applicable, a fair value discount rate was applied.

At the end of 2012, the Bank changed its commitment with respect to certain Bermuda properties which were being used in its operations but are now contemplated for disposal and therefore the properties have been reclassified as held for sale and included in OREO assets in the Consolidated Balance sheet. The reclassification resulted in an $8 million write down of the carrying amount to its fair value less cost to sell. The fair value was based on the discounted cash flow of a projected sale.

(in thousands of Bermuda dollars)

Note 10: Goodwill and Other Intangible Assets

The following table presents goodwill and other intangible assets by business segment:

Goodwill

Business segment	Guernsey	United Kingdom	Total
Balance as at 31 December 2010	6,672	9,345	16,017
Foreign exchange translation adjustment	(38)	(42)	(80)
Balance as at 31 December 2011	6,634	9,303	15,937
Impairment	**-**	**(9,505)**	**(9,505)**
Foreign exchange translation adjustment	**315**	**202**	**517**
Balance as at 31 December 2012	**6,949**	**-**	**6,949**

Customer relationship intangible assets	2012				2011			
	Cost	**Accumulated impairment**	**Accumulated amortisation**	**Net carrying amount**	Cost	Accumulated impairment	Accumulated amortisation	Net carrying amount
Bermuda - Wealth Management	**8,342**	**-**	**(4,590)**	**3,752**	8,342	-	(4,034)	4,308
Cayman	**1,211**	**-**	**(853)**	**358**	1,211	-	(773)	438
Guernsey	**42,952**	**-**	**(31,735)**	**11,217**	41,010	-	(27,542)	13,468
The Bahamas	**5,234**	**(2,019)**	**(3,215)**	**-**	5,234	-	(2,867)	2,367
United Kingdom	**16,927**	**(7,124)**	**(9,803)**	**-**	19,036	-	(9,454)	9,582
Total	**74,666**	**(9,143)**	**(50,196)**	**15,327**	74,833	-	(44,670)	30,163

During the 2012 annual review process, the carrying amount of goodwill relating to the United Kingdom segment was considered fully impaired due to a continuous period of losses incurred and future estimated profitability being unable to sustain current valuations including the goodwill and the customer intangible assets and was therefore fully written off.

Customer relationships are initially valued based on the present value of net cash flows expected to be derived solely from the recurring customer base existing as at the date of acquisition. Customer relationship intangible assets may or may not arise from contracts. The 31 December 2012 fair value of customer relationship intangible assets is based on the present value of net cash flows expected to be derived solely from the recurring originally purchased customer base existing as at 31 December 2012. The discount rate used for testing is the discount rate implied in the initial purchase price acquisition.

The carrying amount of the United Kingdom and Bahamas segments' customer relationship intangible assets were impaired and were fully written off as at 31 December 2012 as the present value of net cash flows expected to be derived for the recurring customer base is no longer providing positive net cash flows.

During 2012 and 2011, the Bank did not acquire new customer relationship intangible assets. Intangible asset impairments for the year ended 31 December 2012 of $9.1 million were recognised. During 2012, the amortisation expense amounted to $5.0 million (2011: $5.4 million) and the foreign exchange translation adjustment decreased the net carrying amount by $0.2 million (2011: increased by $0.07 million). The estimated aggregate amortisation expense for each of the succeeding five years (until 31 December 2017) is $3.5 million.

(in thousands of Bermuda dollars)

Note 11: Customer Deposits and Deposits from Banks

a) By Maturity

	2012			2011		
	Customers	Banks	Total	Customers	Banks	Total
Demand deposits						
Demand deposits - Non-interest bearing	918,814	567	919,381	904,873	-	904,873
Demand deposits - Interest bearing	4,514,312	99,573	4,613,885	4,087,152	118,653	4,205,805
Sub-total - demand deposits	5,433,126	100,140	5,533,266	4,992,025	118,653	5,110,678
Term deposits						
Term deposits maturing within six months	1,763,515	15,965	1,779,480	1,924,973	6,410	1,931,383
Term deposits maturing between six to twelve months	98,051	10,240	108,291	119,110	382	119,492
Term deposits maturing after twelve months	81,101	121	81,222	94,887	121	95,008
Sub-total - term deposits	1,942,667	26,326	1,968,993	2,138,970	6,913	2,145,883
Total	7,375,793	126,466	7,502,259	7,130,995	125,566	7,256,561

b) By Type and Location

	31 December 2012			31 December 2011		
	Payable on demand	Payable on a fixed date	Total	Payable on demand	Payable on a fixed date	Total
Bermuda						
Customers	2,473,454	890,886	3,364,340	2,237,849	1,021,747	3,259,596
Banks	88,169	249	88,418	110,127	-	110,127
Cayman						
Customers	1,468,025	394,159	1,862,184	1,319,357	423,436	1,742,793
Banks	10,643	26,077	36,720	5,692	6,074	11,766
Guernsey						
Customers	1,073,711	296,255	1,369,966	1,018,084	316,172	1,334,256
Banks	1,281	-	1,281	2,834	388	3,222
The Bahamas						
Customers	65,587	4,413	70,000	55,350	3,968	59,318
United Kingdom						
Customers	352,349	356,954	709,303	361,385	373,647	735,032
Banks	47	-	47	-	451	451
Total Customers	5,433,126	1,942,667	7,375,793	4,992,025	2,138,970	7,130,995
Total Banks	100,140	26,326	126,466	118,653	6,913	125,566
Total	5,533,266	1,968,993	7,502,259	5,110,678	2,145,883	7,256,561

(in thousands of Bermuda dollars)

Note 12: Employee Future Benefits

The Bank maintains trusteed 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 financial position of the Bank's defined benefit pension plans and the Bank's post-retirement medical benefits, which is unfunded. The benefit obligations and plan assets are measured as at 31 December 2012 and 2011:

For the year ended	2012		2011	
	Pension plans	**Post-retirement medical benefit plan**	Pension plans	Post-retirement medical benefit plan
Accumulated benefit obligation at year end	**163,106**	**-**	146,897	-
Change in projected benefit obligation				
Opening projected benefit obligation	**152,472**	**91,880**	140,874	81,114
Service cost	**1,687**	**944**	2,638	740
Employee contributions	**215**	**-**	245	-
Interest cost	**7,061**	**4,205**	7,355	4,428
Benefits paid	**(7,754)**	**(2,951)**	(9,377)	(2,047)
Settlement and curtailment of liability	**-**	**-**	(1,800)	-
Plan amendment	**-**	**-**	-	(3,704)
Actuarial loss	**10,696**	**3,048**	13,124	11,349
Foreign exchange translation adjustment	**3,306**	**-**	(587)	-
Closing projected benefit obligation	**167,683**	**97,126**	152,472	91,880
Change in plan assets				
Opening fair value of plan assets	**145,323**	**-**	143,978	-
Actual return on plan assets	**9,040**	**-**	5,458	-
Employer contribution	**13,439**	**2,951**	5,559	2,047
Employee contributions	**215**	**-**	245	-
Benefits paid	**(7,754)**	**(2,951)**	(9,377)	(2,047)
Foreign exchange translation adjustment	**3,438**	**-**	(540)	-
Closing fair value of plan assets	**163,701**	**-**	145,323	-

(in thousands of Bermuda dollars)

Note 12: Employee Future Benefits (continued)

For the year ended	2012		2011	
	Pension plans	Post-retirement medical benefit plan	Pension plans	Post-retirement medical benefit plan
Amounts recognised in the Balance Sheet consist of:				
Prepaid benefit cost included in other assets	2,026	-	5,861	-
Accrued pension benefit cost included in employee future benefits liability	(6,009)	(97,126)	(13,010)	(91,880)
(Deficit) surplus of plan assets over projected benefit obligation at measurement date	(3,983)	(97,126)	(7,149)	(91,880)
Amounts recognised in accumulated other comprehensive income (loss) consist of:				
Net actuarial loss	(49,261)	(27,169)	(40,460)	(26,195)
Past service credit	-	28,347	-	35,066
Net amount recognised in accumulated other comprehensive income (loss)	(49,261)	1,178	(40,460)	8,871

Effective 31 December 2011, the Bermuda Defined Benefit pension benefits were amended to freeze credited service and final average earnings for remaining active members. The benefits amendment resulted in a further reduction in the Bermuda Defined Benefit pension liability of $1.8 million as at 31 July 2011.

Effective January 2012, all the participants of the Bermuda Defined Benefit pension plan are inactive and in accordance with US GAAP, the net actuarial loss of the Bermuda Defined Benefit pension plan is amortised over the estimated average remaining life expectancy of the inactive participants of 22.8 years. Prior to all Bermuda participants being inactive, the net actuarial loss of the Bermuda Defined Benefit pension plan was amortised to net income over the estimated average remaining service period for active members of 4.5 years.

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 year ended	2012		2011	
	Pension plans	Post-retirement medical benefit plan	Pension plans	Post-retirement medical benefit plan
Annual benefit expense				
Service cost	1,687	944	2,638	740
Interest cost	7,061	4,205	7,355	4,428
Expected return on plan assets	(8,145)	-	(9,173)	-
Amortisation of past service credit	-	(6,719)	-	(6,158)
Amortisation of net actuarial loss	1,366	2,074	4,027	935
Defined Benefit expense	1,969	504	4,847	(55)
Defined Contribution expense	5,593	-	5,496	-
Total benefit expense	7,562	504	10,343	(55)
Other changes recognised in other comprehensive income (loss)				
Net (loss) gain arising during the year	(9,864)	(3,048)	(15,082)	(11,349)
Past service credit arising during the year	-	-	-	3,704
Amortisation of past service credit	-	(6,719)	-	(6,158)
Amortisation of net actuarial loss	1,366	2,074	4,027	935
Total changes recognised in other comprehensive income (loss)	(8,498)	(7,693)	(11,055)	(12,868)

The estimated portion of the net actuarial loss for the pension plans that will be amortised from accumulated other comprehensive loss into benefit expense over the next fiscal year is $1.5 million. The estimated portion of the net actuarial loss and the past service credit for the post-retirement medical benefit plan that will be amortised from accumulated other comprehensive loss into benefit expense over the next fiscal year is $2.4 million for the net actuarial loss and a credit of $6.7 million for the past service credit.

	2012		2011	
	Pension plans	Post-retirement medical benefit plan	Pension plans	Post-retirement medical benefit plan
Actuarial assumptions used to determine annual benefit expense				
Weighted average discount rate	4.65%	4.60%	5.30%	5.50%
Weighted average rate of compensation increases	3.95%[(1)]	N/A	3.75%	N/A
Weighted average expected long-term rate of return on plan assets	5.60%	N/A	6.35%	N/A
Weighted average annual medical cost increase rate	N/A	7.5% to 4.5% in 2027	N/A	7.5% to 4.5% in 2027
(1) For 2012 excludes the inactive Bermuda Defined Benefit pension plan				
Actuarial assumptions used to determine benefit obligations at end of year				
Weighted average discount rate	4.20%	4.40%	4.65%	4.60%
Weighted average rate of compensation increases	1.80%	N/A	1.70%	N/A
Weighted average annual medical cost increase rate	N/A	7.5% to 4.5% in 2027	N/A	7.5% to 4.5% in 2027

(in thousands of Bermuda dollars)

Note 12: Employee Future Benefits (continued)

For 2012, the effect of a one percentage point increase or decrease in the assumed medical cost increase rate on the aggregate of service and interest costs is a 1.1 million increase (2011: $1.0 million) and a $0.9 million decrease (2011: $0.8 million), respectively, and on the benefit obligation a $19.1 million increase (2011: $17.2 million) and a $15.3 million decrease (2011: $13.8 million), respectively.

To develop the expected long-term rate of return on the plan assets assumption for each plan, the Bank considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocations of the funds. The weighted average discount rate used to determine benefit obligations at the end of the year is derived from interest rates on high quality corporate bonds with maturities that match the expected benefit payments. The weighted average annual medical cost increase rate remained unchanged in 2012 at 7.5% to 4.5%.

Investments policies and strategies

The pension plans' assets are managed according to each plan's Investment Policy Statement which outlines the Purpose of the Plan, Statement of Objectives and Guidelines & Investment Policy. The asset allocation is diversified and any use of derivatives is limited to hedging purposes only.

The weighted average actual and target asset allocations of the pension plans by asset category are as follows:

	2012		2011	
	Actual allocation	**Target allocation**	Actual allocation	Target allocation
Asset category				
Debt securities (including debt mutual funds)	**48%**	**51%**	45%	40%
Equity securities (including equity mutual funds)	**50%**	**47%**	50%	47%
Other	**2%**	**2%**	5%	13%
Total	**100%**	**100%**	100%	100%

Fair value measurements of pension plans' assets

The following table presents the fair value of plans assets by category and level of Inputs used in their respective fair value determination as described in Note 2.

	2012				2011			
	Fair value determination				Fair value determination			
	Level 1	**Level 2**	**Level 3**	**Total fair value**	Level 1	Level 2	Level 3	Total fair value
US government and federal agencies	**-**	**9,389**	**-**	**9,389**	-	5,890	-	5,890
Corporate debt securities	**-**	**57,491**	**-**	**57,491**	-	51,295	-	51,295
Debt securities issued by non-US governments	**-**	**12,232**	**-**	**12,232**	-	10,143	-	10,143
Equity securities and mutual funds	**-**	**81,112**	**-**	**81,112**	-	74,089	385	74,474
Other	**-**	**3,477**	**-**	**3,477**	-	3,521	-	3,521
Total fair value of plans' assets	**-**	**163,701**	**-**	**163,701**	-	144,938	385	145,323

At 31 December 2012, 32.9% (2011: 26.3 %) of the assets of the pension plans were mutual funds and equity securities managed or administered by wholly-owned subsidiaries of the Bank. At 31 December 2012, 0.2% and 1.4% (2011: 0.2% and 1.6%) of the plans' assets were invested in Common and Preference Shares of the Bank respectively.

The investments of the pension funds are diversified across a range of asset classes and are diversified within each asset class. The assets are generally actively managed with the goal of adding some incremental value through security selection and asset allocation.

Estimated 2012 Bank contribution to, and estimated benefit payments for the next ten years under, the pension and post-retirement medical benefit plans are as follows:

2012	**Pension Plans**	**Post-retirement medical benefit plan**
Estimated Bank contributions for 2013	**7,816**	**3,033**
Estimated benefit payments by year:		
2013	**6,000**	**3,033**
2014	**6,200**	**3,270**
2015	**6,500**	**3,554**
2016	**6,700**	**3,790**
2017	**6,800**	**4,033**
2018 - 2021	**35,800**	**24,220**

The projected benefit obligation and fair value of plan assets for pension plans with projected benefit obligations in excess of plan assets were $137.8 million and $131.9 million as at 31 December 2012 (2011: $127.5 million and $114.5 million).

(In thousands of Bermuda dollars)

Note 13: Credit-Related Arrangements and Commitments

Commitments

The Bank was committed to expenditures under contract for sourcing and leases of $75.4 million and $24.7 million respectively as at 31 December 2012 (2011: $112.5 million and $30.2 million respectively). Rental expense for premises leased on a long-term basis for the year ended 31 December 2012 amounted to $4.7 million (2011: $4.6 million).

The following table summarises the Bank's commitments for sourcing, long-term leases and other agreements:

2012	Sourcing	Leases	Other agreements	Total
2013	20,883	5,143	4,097	30,123
2014	19,514	5,029	3	24,546
2015	19,252	4,447	1	23,700
2016	15,769	3,617	-	19,386
2017	-	2,974	-	2,974
2018 & thereafter	-	3,555	-	3,555
Total commitments	75,418	24,765	4,101	104,284

Credit-Related Arrangements

Standby letters of credit and letters of guarantee are issued at the request of a Bank customer in order to secure the customer's payment or performance obligations to a third party. These guarantees represent an irrevocable obligation of the Bank to pay the third party beneficiary upon presentation of the guarantee and satisfaction of the documentary requirements stipulated therein, without investigation as to the validity of the beneficiary's claim against the customer. Generally, the term of the standby letters of credit does not exceed one year, whilst the term of the letters of guarantee does not exceed four years. The types and amounts of collateral security held by the Bank for these standby letters of credit and letters of guarantee is generally represented by deposits with the Bank or a charge over assets held in mutual funds.

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:

	2012			2011		
	Gross	Collateral	Net	Gross	Collateral	Net
Standby letters of credit	280,089	277,259	2,830	320,968	303,769	17,199
Letters of guarantee	11,207	8,694	2,513	13,147	9,876	3,271
Total	291,296	285,953	5,343	334,115	313,645	20,470

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:

	2012	2011
Commitments to extend credit	356,122	483,020
Commitments to extend credit with terms modified by troubled debt restructuring	-	779
Documentary and commercial letters of credit	1,258	4,520
Total	357,380	488,319

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 31 December 2012, $137.0 million (2011: $137.1 million) of standby letters of credit were issued under this facility.

On 31 December 2010, the Bank entered a credit line facility of up to $150.0 million with the same custodian. The custodian had the right of set-off against the scaled market value of the Bank's investment portfolio. There were no draws on this facility during the year ended 31 December 2011. The facility expired on 31 December 2011.

Guarantees

As part of the BFG disposal negotiations, the Bank guaranteed to purchase services from BFG, on normal commercial market terms, for three years at minimum agreed revenue levels of $5.5 million, $5.0 million and $4.5 million per annum. In the event there is a shortfall, the Bank is required to pay 38% of the shortfall. Renegotiations of agreements occurred during the third and fourth quarter of 2011 resulting in an expected shortfall from the revenue guarantees over the three-year period whereby the resultant fair value of the liability is estimated at approximately $0.5 million as at 31 December 2012.

(In thousands of Bermuda dollars)

Note 13: 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 14: Interest Income

Loans

The following table presents the components of loan interest income:

	2012	2011
Mortgages	**88,263**	89,446
Other loans	**100,594**	96,401
	188,857	185,847
Amortisation of fair value hedge	**(2,578)**	(2,498)
Amortisation of loan origination fees (net of amortised costs)	**4,412**	4,692
Total loan interest income	**190,691**	188,041
Balance of unamortised fair value hedge as at 31 December	**(9,078)**	(11,656)
Balance of unamortised loan fees as at 31 December	**7,452**	7,567

Note 15: Segmented Information

At 31 December 2012, 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.

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 community and commercial banking services to private and corporate customers through three locations and through Internet banking, ATMs and debit cards. Wealth management and fiduciary services are also provided.

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 institutional, corporate and private clients with a range of wealth management & fiduciary 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 3: Discontinued operations.

Total Assets by Segment

	2012	2011
Bermuda	**4,733,057**	4,574,921
Cayman	**2,116,520**	1,974,338
Guernsey	**1,522,429**	1,479,901
Switzerland	**1,521**	1,118
The Bahamas	**82,712**	77,565
United Kingdom	**925,389**	976,451
Total assets from continuing operations	**9,381,628**	9,084,294
Total assets from discontinued operations	**-**	307,044
	9,381,628	9,391,338
Less: inter-segment eliminations	**(439,598)**	(566,988)
Total	**8,942,030**	8,824,350

(in thousands of Bermuda dollars)

Note 15: Segmented Information *(continued)*

For the year ended 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	128,817	1,316	(6,372)	65,559	189,320	164,232	25,088	(12,974)	12,114
Cayman	43,413	1,220	(1,291)	30,940	74,282	54,829	19,453	4,497	23,950
Guernsey	21,618	(54)	(980)	20,005	40,589	30,810	9,779	(31)	9,748
Switzerland	1	-	-	1,442	1,443	2,464	(1,021)	-	(1,021)
The Bahamas	135	395	-	4,761	5,291	5,579	(288)	(2,018)	(2,306)
United Kingdom	17,074	(2,877)	(5,547)	8,177	16,827	24,565	(7,738)	(16,895)	(24,633)
Total before eliminations	211,058	-	(14,190)	130,884	327,752	282,479	45,273	(27,421)	17,852
Add / (Less): inter-segment eliminations / transactions	-	-	-	(2,341)	(2,341)	(2,341)	-	109	109
Total from continuing operations	211,058	-	(14,190)	128,543	325,411	280,138	45,273	(27,312)	17,961

For the year ended 2011	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	131,671	881	(1,202)	67,080	198,430	176,725	21,705	4,753	26,458
Cayman	36,568	757	(3,974)	30,651	64,002	54,987	9,015	1,956	10,971
Guernsey	18,396	(17)	(636)	21,665	39,408	30,245	9,163	242	9,405
Switzerland	1	-	-	662	663	2,075	(1,412)	-	(1,412)
The Bahamas	1,041	264	(633)	5,114	5,786	5,788	(2)	3	1
United Kingdom	14,572	(1,885)	(6,724)	10,928	16,891	20,253	(3,362)	45	(3,317)
Total before eliminations	202,249	-	(13,169)	136,100	325,180	290,073	35,107	6,999	42,106
Add / (Less): inter-segment eliminations / transactions	-	-	-	(3,751)	(3,751)	(3,751)	-	(2,761)	(2,761)
Total from continuing operations	202,249	-	(13,169)	132,349	321,429	286,322	35,107	4,238	39,345

Note 16: 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 primarily enters into 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 interest rate 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 derivative instruments to hedge its exposure to interest rate risk and foreign currency risk. Certain hedging relationships are formally designated and qualify for hedge accounting as fair value or cash flow hedges. Other derivatives that are entered into for risk management purposes as economic hedges are not formally designated as hedges and, therefore, are accounted for as if they were trading instruments. In order to qualify for hedge accounting, a formal assessment is performed on a calendar quarter basis to verify that derivatives used in designated hedging transactions continue to be highly effective as offsets to changes in fair value or cash flows of the hedged item. If a derivative ceases to be highly effective, or if the hedged item matures, is sold, or is terminated, hedge accounting is terminated and the derivative is treated as if it were a trading instrument.

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.

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 Bank's non-USD investments in subsidiaries. Changes in the fair value of derivative instruments not formally designated as hedges are recognised in 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.

(in thousands of Bermuda dollars)

Note 16: Accounting for Derivative Instruments and Risk Management (continued)

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.

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)
Subtotal fair-value hedges		8,529	-	(89)	(89)
Derivatives not formally designated as hedging instruments					
	Currency swaps	343,684	113	(10,895)	(10,782)
Subtotal not designated as hedges		343,684	113	(10,895)	(10,782)
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)

2011	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	11,436	-	(227)	(227)
Investments	Interest rate swaps	18,613	18	-	18
Subtotal fair-value hedges		30,049	18	(227)	(209)
Derivatives not formally designated as hedging instruments					
	Currency swaps	346,453	1,031	(105)	926
	Foreign currency options	65,335	3,160	(651)	2,509
Subtotal not designated as hedges		411,788	4,191	(756)	3,435
Subtotal risk management derivatives		441,837	4,209	(983)	3,226
Client services derivatives					
	Spot and forward foreign exchange	5,775,477	44,207	(43,756)	451
	Interest rate caps	37,225	89	(89)	-
Subtotal client services derivatives		5,812,702	44,296	(43,845)	451
Total derivative instruments		6,254,539	48,505	(44,828)	3,677

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

		For the year ended	
Derivative instrument	**Consolidated Statement of Operations line item**	**2012**	2011
Interest rate swaps	Net other gains (losses)	-	(906)
Forward foreign exchange	Foreign exchange revenue	1,823	699
Foreign currency options	Foreign exchange revenue	(852)	1,092
Total net gains recognised in net income		971	885

(in thousands of Bermuda dollars)

Note 17: 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, as described in Note 2.

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, as described in Note 2.

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.

Items that are recognised at fair value on a recurring basis	**2012 Fair value**				2011 Fair value			
	Level 1	**Level 2**	**Level 3**	**Total carrying amount / Fair value**	Level 1	Level 2	Level 3	Total carrying amount / Fair value
Financial assets								
Trading								
Debt securities issued by non-US governments	-	5,231	-	5,231	-	5,971	-	5,971
Mutual funds	5,337	51,217	-	56,554	5,368	51,252	-	56,620
Total Trading	5,337	56,448	-	61,785	5,368	57,223	-	62,591
Available for sale								
Certificates of deposit	-	561,360	-	561,360	-	356,493	-	356,493
US government and federal agencies	-	1,178,786	-	1,178,786	-	790,804	-	790,804
Debt securities issued by non-US governments	-	90,042	-	90,042	-	88,658	-	88,658
Corporate debt securities guaranteed by non-US governments	-	32,026	-	32,026	-	121,648	-	121,648
Corporate debt securities	-	421,085	-	421,085	-	405,249	-	405,249
Asset-backed securities - Student loans	-	124,937	11,164	136,101	-	133,182	11,164	144,346
Mortgage-backed securities - Commercial	-	130,478	-	130,478		-	-	-
Pass-through note	-	-	30,646	30,646	-	-	26,991	26,991
Equity securities	-	53	-	53	-	70	-	70
Total Available for sale	-	2,538,767	41,810	2,580,577	-	1,896,104	38,155	1,934,259
Other assets - Derivatives	-	14,425	-	14,425	-	48,505	-	48,505
Other assets - Closed ended real estate fund	-	-	4,397	4,397	-	-	6,199	6,199
Financial liabilities								
Other liabilities – Derivatives	-	(24,956)	-	(24,956)	-	(44,828)	-	(44,828)

Transfers of securities	**2012**		2011	
	Trading investments	**Available-for-sale investments**	Trading investments	Available-for-sale investments
Transfers out of Level 1	-	-	(50,035)	-
Transfers in to Level 2	-	-	50,035	-

The transfer out of Level 1 and into Level 2 represents transfers of a mutual fund classified at measurement date based on the level of trading.

(in thousands of Bermuda dollars)

Note 17: Fair Value of Financial Instruments (continued)

The following table presents quantitative information about recurring fair value measurements of assets classified with Level 3 of the fair value hierarchy as of 31 December 2012.

Financial Instrument Type	Valuation Technique	Fair Value
Asset-backed securities - Student loans	Unadjusted third party priced	11,164
Pass-through note	Unadjusted third party priced	30,646
Closed ended real estate fund	Net asset value of fund	4,397

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. 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.

Net Asset value of fund

The per-share dollar amount of the fund is calculated by dividing the total value of all the assets in its portfolio, less any liabilities, by the number of fund shares outstanding.

Level 3 reconciliation	2012		2011	
	Available-for-sale investments	Closed ended property fund	Available-for-sale investments	Closed ended property fund
Carrying amount at beginning of year	38,155	6,199	44,483	9,044
Purchases	-	-	290	1,185
Proceeds from sale / Capital distributions	(4,992)	(1,154)	(3,973)	(3,765)
Accretion recognised in net income	1,701	-	1,776	-
Realised and unrealised gains (losses) recognised in other comprehensive income	6,946	33	(4,421)	(251)
Transfers in and out of Level 3	-	-	-	-
Foreign exchange translation adjustment	-	(681)	-	(14)
Carrying amount at end of year	41,810	4,397	38,155	6,199

(in thousands of Bermuda dollars)

Note 17: Fair Value of Financial Instruments (continued)

	2012 Fair value				2011 Fair value			
Items that are recognised at fair value on a non-recurring basis	**Level 1**	**Level 2**	**Level 3**	**Total carrying amount / Fair value**	Level 1	Level 2	Level 3	Total carrying amount / Fair value
Other real estate owned	**-**	**34,360**	**-**	**34,360**	-	27,354	-	27,354

Consistent with the significant accounting policy in Note 2, 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

	2012			2011		
	Carrying amount	**Fair value**	**Appreciation / (depreciation)**	Carrying amount	Fair value	Appreciation / (depreciation)
Financial assets						
Cash and cash equivalents	**1,651,547**	**1,651,547**	**-**	1,902,726	1,902,726	-
Short-term investments	**76,213**	**76,213**	**-**	20,280	20,280	-
Investments held to maturity	**239,342**	**244,793**	**5,451**	64,789	64,588	(201)
Loans, net of allowance for credit losses	**3,955,960**	**3,946,081**	**(9,879)**	4,069,419	4,060,193	(9,226)
Financial liabilities						
Customer deposits						
Demand deposits	**5,433,126**	**5,433,126**	**-**	4,992,025	4,992,025	-
Term deposits	**1,942,667**	**1,944,531**	**(1,864)**	2,138,970	2,142,748	(3,778)
Deposits from banks	**126,466**	**126,466**	**-**	125,666	125,666	-
Subordinated capital	**260,000**	**254,127**	**5,873**	267,755	225,019	42,736

All of the Held to maturity securities held by the Bank as at 31 December 2012 and 2011 are classified as Level 2 of the fair value hierarchy.

(in thousands of Bermuda dollars)

Note 18: 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.

2012	Earlier of maturity or repricing date						
(in $ millions)	**Within 3 months**	**3 to 6 months**	**6 to 12 months**	**1 to 5 years**	**After 5 years**	**Non-interest bearing funds**	**Total**
Assets							
Cash and cash equivalents	1,435	-	-	-	-	217	1,652
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
Premises, equipment and computer software	-	-	-	-	-	243	243
Other assets	-	-	-	-	-	133	133
Total assets	5,662	502	88	659	1,330	701	8,942
Liabilities and Shareholders' equity							
Shareholders' equity	-	-	-	-	-	857	857
Demand deposits	4,614	-	-	-	-	919	5,533
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
Total liabilities and Shareholders' equity	6,389	304	108	126	25	1,990	8,942
Interest rate swaps	8	-	(8)	-	-	-	-
Interest rate sensitivity gap	(719)	198	(28)	533	1,305	(1,289)	-
Cumulative interest rate sensitivity gap	(719)	(521)	(549)	(16)	1,289	-	-

2011	Earlier of maturity or repricing date						
(in $ millions)	Within 3 months	3 to 6 months	6 to 12 months	1 to 5 years	After 5 years	Non-interest bearing funds	Total
Assets							
Cash and cash equivalents	1,709	-	-	-	-	194	1,903
Short-term investments	12	5	3	-	-	-	20
Investments	451	207	123	440	784	57	2,062
Loans	3,508	117	36	310	51	47	4,069
Premises, equipment and computer software	-	-	-	-	-	272	272
Other assets	-	-	-	-	-	498	498
Total assets	5,680	329	162	750	835	1,068	8,824
Liabilities and Shareholders' equity							
Shareholders' equity	-	-	-	-	-	830	830
Demand deposits	4,205	-	-	-	-	905	5,110
Term deposits	1,667	265	119	95		-	2,146
Other liabilities	-	-	-	-	-	470	470
Subordinated capital	98	-	-	145	25	-	268
Total liabilities and Shareholders' equity	5,970	265	119	240	25	2,205	8,824
Interest rate swaps	2	8	(2)	(8)	-	-	-
Interest rate sensitivity gap	(288)	72	41	502	810	(1,137)	-
Cumulative interest rate sensitivity gap	(288)	(216)	(175)	327	1,137	-	-

(in thousands of Bermuda dollars)

Note 19: Subordinated Capital

On 28 May 2003, the Bank issued US $125 million of Subordinated Lower Tier II capital notes. The notes were issued at par and in two tranches, namely US $78 million in Series A notes due 2013 and US $47 million in Series B notes due 2018. The issuance was by way of private placement with US institutional investors. The notes are listed on the Bermuda Stock Exchange ("BSX") in the specialist debt securities category. Part proceeds of the issue were used to repay the entire amount of the US $75 million outstanding subordinated notes redeemed in July 2003. The notes issued under Series A paid a fixed coupon of 3.94% until 27 May 2008 when it was redeemed in whole by the Bank. The Series B notes pay a fixed coupon of 5.15% until 27 May 2013 when they become redeemable in whole at the Bank's option. The Series B notes were priced at a spread of 1.35% over the 10-year US Treasury yield.

On 2 April 2004, in conjunction with the acquisition of Leopold Joseph, the Bank assumed a subordinated debt of £5 million which is included in the Balance Sheet in the amount of $7.8 million. The issuance was by way of private placement in the United Kingdom and paid a fixed coupon of 9.29% until February 2012 when it became redeemable in whole at the option of the Bank and 10.29% thereafter until February 2017. During February 2012, the Bank exercised its option to redeem the United Kingdom note outstanding at face value.

On 27 June 2005, the Bank issued US $150 million of Subordinated Lower Tier II capital notes. The notes were issued at par in two tranches, namely US $90 million in Series A notes due 2015 and US $60 million in Series B notes due 2020. The issuance was by way of private placement with US institutional investors. The notes are listed on the BSX in the specialist debt securities category. The notes issued under Series A paid a fixed coupon of 4.81% until 2 July 2010 after which the coupon rate became floating and the principal became redeemable in whole at the Bank's option. At 31 December 2012, the Bank has not redeemed any of the notes issues under Series A and effective 2 July 2010 the coupon rate became floating at 3 months US$ LIBOR + 1.095%. The Series B notes pay a fixed coupon of 5.11% until 2 July 2015 when they also become redeemable in whole at the Bank's option. The Series A notes were priced at a spread of 1.00% over the 5-year US Treasury yield and the Series B notes were priced at a spread of 1.10% over the 10-year US Treasury yield. During September 2011, the Bank repurchased a portion of the outstanding 5.11% 2005 Series B Subordinated notes ("the Note"). The face value of the portion of the Note repurchased was $15 million and the purchase price paid for the repurchase was $13.875 million, which realised a gain of $1.125 million.

On 27 May 2008, the Bank issued US $78 million of Subordinated Lower Tier II capital notes. The notes were issued at par and in two tranches, namely US $53 million in Series A notes due 2018 and US $25 million in Series B notes due 2023. The issuance was by way of private placement with US institutional investors. The notes are listed on the BSX in the specialist debt securities category. The proceeds of the issue were used to repay the entire amount of the US $78 million outstanding subordinated notes redeemed in May 2008. The notes issued under Series A pay a fixed coupon of 7.59% until 27 May 2013 when they become redeemable in whole at the option of the Bank. The Series B notes pay a fixed coupon of 8.44% until 27 May 2018 when they also become redeemable in whole at the Bank's option. The Series A notes were priced at a spread of 4.34% over the 5-year US Treasury yield and the Series B notes were priced at a spread of 4.51% over the 10-year US Treasury yield.

No interest was capitalised during 2012 (2011: $2.8 million).

The following table presents the contractual maturity and interest payments for subordinated capital issued by the Bank as at 31 December 2012. The interest payments are calculated until contractual maturity using the current LIBOR rates.

						Interest payments until contractual maturity		
Subordinated capital	**Earliest date redeemable**	**Contractual maturity date**	**Interest rate until date redeemable**	**Interest rate from earliest date redeemable to contractual maturity**	**Principal outstanding**	**Within 1 year**	**1 to 5 years**	**After 5 years**
Bermuda								
2003 issuance - Series B	27 May 2013	27 May 2018	5.15%	3 months US$ LIBOR + 2.000%	47,000	1,757	4,338	537
2005 issuance - Series A	2 July 2010	2 July 2015	4.81%	3 months US$ LIBOR + 1.095%	90,000	1,261	2,204	-
2005 issuance - Series B	2 July 2015	2 July 2020	5.11%	3 months US$ LIBOR + 1.695%	45,000	2,300	6,629	2,477
2008 issuance - Series A	27 May 2013	27 May 2018	7.59%	3 months US$ LIBOR + 4.185%	53,000	3,211	9,527	1,180
2008 issuance - Series B	27 May 2018	27 May 2023	8.44%	3 months US$ LIBOR + 4.929%	25,000	2,110	8,440	7,602
Total					**260,000**	**10,639**	**31,138**	**11,796**

Note 20: 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.

	2012	2011
Basic Earnings per Share (1)	**0.01**	0.03
Basic earnings per Share from continuing operations	**-**	0.03
Basic earnings per Share from discontinued operations	**0.01**	-
Net income for the year	**17,961**	39,345
Less: Preference dividends declared and guarantee fee	**(18,000)**	(21,270)
Net income from continuing operations attributable for Common Shareholders	**(39)**	18,075
Net income from discontinued	**7,620**	1,127
Net income attributable for Common Shareholders	**7,581**	19,202
Weighted average number of participating Shares	**556,933**	556,933
Weighted average number of Common Shares held as Treasury stock	**(2,515)**	(2,283)
Adjusted weighted average number of Common Shares	**554,418**	554,650
Diluted Earnings per Share (1)	**0.01**	0.03
Diluted earnings per Share from continuing operations	**-**	0.03
Diluted earnings per Share from discontinued operations	**0.01**	-
Net income from continuing operations attributable for Common Shareholders	**(39)**	18,075
Net income from discontinued	**7,620**	1,127
Net income attributable for Common Shareholders	**7,581**	19,202
Adjusted weighted average number of Common Shares	**554,418**	554,650
Weighted average number of dilutive Share-based awards	**1,939**	965
Adjusted weighted average number of diluted Common Shares	**556,357**	555,615

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

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 2012, weighted-average options to purchase $33.3 million (2011: 34.5 million) Shares of Common stock (see Note 21), 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 89,835 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 2012 the weighted-average number of outstanding awards of unvested Common Shares (see Note 21) was 7.2 million (2011: 3.8 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' yet 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 $3.61 for 4.15 million Shares of Common stock were not included in the computation of earnings per Share in 2012 and 2011 because the exercise price was greater than the average market price of the Bank's Common stock.

(in thousands of Bermuda dollars)

Note 21: Share-Based Payments

As at 31 December 2012, 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 $9.6 million. If the probability of a Valuation Event becomes more likely than not, some or all of the $9.6 million unrecognised expense relating to the performance vesting options will be recognised as an expense.

The table below presents the weighted average fair value of stock options granted:

	Time Vested Options	Performance Options
Weighted average fair value of stock options granted in the year ended 31 December 2012	**$0.42**	**$0.44**
Weighted average fair value of stock options granted in the year ended 31 December 2011	$0.41	$0.43
Weighted average fair value of stock options granted in the year ended 31 December 2010	$0.62	$0.66

The weighted average fair value of stock options granted in the year ended 31 December 2012 was calculated using the Black-Scholes-Merton option-pricing model for the Time Vested Options and a lattice-based binomial option-pricing model for the Performance Options using the following weighted average assumptions:

	Time Vested Options	Performance Options
Projected dividend yield	0% for 2010-2013 1.0% for 2014 2.0% for 2015 and later years	0% for 2010-2013 1.0% for 2014 2.0% for 2015 and later years
Risk-free interest rate	0.94% to 1.44%	0% to 2.09%
Projected volatility	36% to 38%	36% to 38%
Expected life (years)	6.75 years	8 to 10 years

The projected dividend yield is based on the Bank's best estimate at grant date. The projected volatilities are based on the historical trading prices of the Bank's Common Shares. The risk-free interest rate for periods within the expected life of the option is based on the US Treasuries yield curve in effect at the time of grant. As the time vested options granted are "plain vanilla" options, the Bank uses one-half of the time between the average vesting date and the full option term to estimate the expected option life; separate groups of employees that have similar historical exercise behaviour are considered separately for valuation purposes.

(in thousands of Bermuda dollars)

Note 21: Share-Based Payments (continued)

The table below presents the number of Shares transferable upon exercise of the options outstanding at 31 December:

	2012					
	Number of Shares transferable upon exercise (thousands)			Weighted average exercise price	Weighted average life remaining	Aggregate intrinsic value
	1997 Stock Option Plan	2010 Stock Option Plan	Total	$	years	$ thousands
Outstanding at beginning of year	**5,269**	**28,363**	**33,632**	**3.02**		
Granted	**-**	**3,100**	**3,100**	**1.25**		
Exercised	**-**	**(5)**	**(5)**	**1.21**		
Forfeited / cancelled	**(543)**	**(2,062)**	**(2,605)**	**3.84**		
Resignations / Retirement / Redundancy	**-**	**(646)**	**(646)**	**1.21**		
End of plan expiration	**(149)**	**-**	**(149)**	**6.87**		
Outstanding at end of year	**4,577**	**28,750**	**33,327**	**2.81**	**7.14**	**1,245**
Vested and exercisable at end of year	**4,577**	**3,598**	**8,175**	**7.71**	**5.47**	

	2011					
	Number of Shares transferable upon exercise (thousands)			Weighted average exercise price	Weighted average life remaining	Aggregate intrinsic value
	1997 Stock Option Plan	2010 Stock Option Plan	Total	$	years	$ thousands
Outstanding at beginning of year	6,274	28,034	34,308	3.26		
Granted	-	1,260	1,260	1.24		
Exercised	-	-	-	-		
Forfeited / cancelled	(847)	(25)	(872)	11.1		
Resignations / Retirement / Redundancy	-	(906)	(906)	1.22		
End of plan expiration	(158)	-	(158)	5.84		
Outstanding at end of year	5,269	28,363	33,632	2.81	7.85	-
Vested and exercisable at end of year	5,269	162	5,431	12.41	4.95	

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.

	For the year ended	
	2012	2011
	Number of Shares transferable upon vesting (thousands)	Number of Shares transferable upon vesting (thousands)
Outstanding at beginning of year	**1,276**	-
Granted	**1,554**	1,361
Vested	**(477)**	(11)
Forfeited / cancelled	**(377)**	(74)
Outstanding unvested at end of year	**1,976**	1,276

(in thousands of Bermuda dollars)

Note 21: Share-Based Payments (continued)

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 three-year period from the effective grant date.

	For the year ended 2012	2011
	Number of Shares transferable upon vesting (thousands)	Number of Shares transferable upon vesting (thousands)
Outstanding at beginning of year	2,515	-
Granted	4,056	2,560
Vested	(928)	(10)
Forfeited / cancelled	(412)	(35)
Outstanding at end of year	5,231	2,515

The Board approved the 2011 Employee Deferred Incentive Plan and the 2012 Executive Long-Term Incentive Share Plan on the 28th of February 2012.

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 year ended 2012			2011		
	Stock option plans	EDIP and ELTIP	Total	Stock option plans	EDIP and ELTIP	Total
Share-based compensation plans – continuing operations						
Awards granted in years 2010, 2011 and 2012	1,398	3,723	5,121	1,719	1,845	3,564
Share-based compensation plans – discontinued operations						
Awards granted in years 2010, 2011 and 2012	-	63	63	(16)	31	15
Total Share-based compensation	1,398	3,786	5,184	1,703	1,876	3,579
Share-based settlement plans						
Directors' Shares and retainers settlement plans			293			344
Total Share-based payments			5,477			3,923

The following table presents the unrecognised expense attributable each plan.

Unrecognised expense	For the year ended 2012	2011
2010, 2011 and 2012 Stock Option Plan		
Time Vesting Options	3,665	5,731
Performance Vesting Options	9,608	9,169
2011 and 2012 EDIP	1,557	915
2011 and 2012 ELTIP		
Time Vesting Shares	1,914	952
Performance Vesting Shares	2,358	961
	19,102	17,728

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.

Note 22: Share Buy-Back Plans

The Bank introduced a Share Buy-Back Programme on 1 May 2012 as a means to improve Shareholder liquidity and facilitate growth in Share value. Under this Programme, up to six million Common Shares and 2,000 Preference Shares may be repurchased. On 10 December 2012, the Board of the Bank approved increasing the number of Common Shares available for repurchase up to 10 million and the number of Preference Shares up to 8,000.

During 2012 the Bank repurchased 7.3 million Common Shares to be held as Treasury Shares at a cost of $9 million and 4,422 Preference Shares, which were subsequently cancelled, at a cost of $5.4 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 and Shares purchased by the Bank's Stock Option Trust.

Note 23: Capital Structure

Authorised capital

The Bank's total authorised Share capital as of 31 December 2012 and 2011 consisted of (i) 26 billion Common Shares of par value BD$0.01, (ii) 100,200,001 Preference Shares of par value US$0.01 and (iii) 50 million Preference Shares of par value £0.01.

Following the Bank's Annual General Meeting held on 8 April 2010, The Bank of N.T. Butterfield & Son Limited's Shareholders approved an increase in the authorised Share capital to 26,000,000,000 Common Shares of par value BD$0.01.

Preference Shares

On 22 June 2009, the Bank issued 200,000 Government guaranteed, 8.00% Non-Cumulative Perpetual Limited Voting Preference Shares (the "Preference Shares"). The issuance price was US$1,000 per Share. During 2012, the Bank repurchased and cancelled 4,422 Preference Shares for a net cost of $5.4 million. As at 31 December 2012, 195,578 Preference shares were outstanding.

The Preference Share principal and dividend payments are guaranteed by the Government of Bermuda. At any time after the expiry of the guarantee offered by the Government of Bermuda, and subject to the approval of the Bermuda Monetary Authority, the Bank may redeem, in whole or in part, any Preference Shares at the time issued and outstanding, at a redemption price equal to the liquidation Preference plus any unpaid dividends at the time.

Holders of Preference Shares will be entitled to receive, on each Preference Share only when, as and if declared by the Board of Directors, non-cumulative cash dividends at a rate per annum equal to 8.00% on the liquidation preference of $1,000 per Preference Share payable quarterly in arrears. In exchange for the Government's commitment, the Bank issued to the Government 4,279,601 warrants to purchase Common Shares of the Bank at an exercise price of $7.01. The warrants expire on 22 June 2019. During 2010, the warrants issued to the Government were adjusted in accordance with the terms of the guarantee and as a result now holds 4,150,774 warrants with an exercise price of $3.61.

On 11 May 2010 the Bank's Rights offering were over subscribed with the maximum allowable number of rights of 107,438,016 exercised and subsequently converted on the ratio of 0.07692 Contingent Value Convertible Preference Shares ("CVCP") for each right unit exercised amounting to 8,264,157 CVCP issued. The CVCP have specific rights and conditions attached which is explained in detail in the Prospectus of The Rights Offering.

Regulatory capital

The Bank is subject to Basel II which is a risk-based capital adequacy framework developed by the Basel Committee on Banking Supervision (the "Basel Committee") and has been endorsed by the central bank governors and heads of bank supervision of the G10 countries. In December 2008, the Bermuda Monetary Authority published final rules, effective 1 January 2009, with respect to the implementation of the Basel II framework. From this date the Bank has calculated its capital requirement on the Standardised approach under Basel II requirements.

The Bank is fully compliant with all regulatory capital requirements and maintains capital ratios well in excess of regulatory minimums as at 31 December 2012 and 2011. As at 31 December 2012, the Bank's regulatory capital stood at $1,034 million (2011: $1,041 million) with risk weighted assets of $4,275 million (2011: $4,426 million). Consolidated Tier 1 total and Total Capital ratios being 18.5% and 24.2%, respectively (2011: 17.7% and 23.5%, respectively).

Note 24: Disposal of affiliates

On 8 February 2011, the Bank entered into an agreement with an investor group (comprised of BV Investor Partners, Glen Henderson and Tim Calveley, "BV Investor Group") to dispose of its 36% equity interest on a diluted basis in Butterfield Fulcrum Group Limited ("BFG"). The sale was completed in the second quarter of 2011 and resulted in a gain on sale of $3.2 million.

On 5 April 2012, the Bank sold its 27.76% interest in Island Heritage Holdings Ltd.; a Cayman-based insurance company, to BF&M Limited. The sale was completed in the second quarter of 2012 with gross proceeds on the sale of $18.5 million, resulting in a gain of $4.2 million.

Note 25: Variable Interest Entities

The Bank had no investments in variable interest entities for which it was deemed the primary beneficiary for the years ended 31 December 2012 and 2011.

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.

(in thousands of Bermuda dollars)

Note 26: Income Taxes

The Bank is incorporated in Bermuda, and pursuant to Bermuda law is not taxed on either income or capital gains. The Bank's subsidiaries in the Cayman Islands and The Bahamas are not subject to any taxes in their respective jurisdictions on either income or capital gains under current law applicable in the respective jurisdictions. The Bank's subsidiaries in the United Kingdom, Guernsey, Barbados (prior to disposal) and Switzerland are subject to the tax laws of those jurisdictions.

For the years ended 31 December 2012 and 2011, the Bank did not record any unrecognised tax benefits or expenses and has no uncertain tax positions as at 31 December 2012 and 2011.

The Bank records income taxes based on the enacted tax laws and rates applicable in the relevant jurisdictions for each of the years ended 31 December 2012 and 2011. For the years ended 31 December 2012 and 2011, the Bank did not incur any interest or pay any penalties.

The components of income taxes attributable to the Bank's subsidiaries' operations for the years ended 31 December 2012 and 2011 were as follows:

31 December	2012	2011
Income taxes in Consolidated Statement of Operations		
Current tax expense	936	789
Deferred tax expense (benefit)	4,954	(1,095)
Total tax expense (benefit)	**5,890**	(306)

The reconciliation between the Bank's effective tax rate on income from continuing operations and the statutory tax rate is as follows:

31 December	2012		2011	
	$	%	$	%
Income tax expense at Bermuda corporation tax rate of 0%	-	-	-	-
Income tax expense in international offices taxed at different rates	841	4	1,742	4
Change in valuation allowance	4,132	17	-	-
Prior year tax adjustments	900	4	(303)	(1)
Tax loss carried forward	-	-	(1,451)	(4)
Change in tax rate	-	-	245	1
Other — net	17	-	(539)	(1)
Income tax expense (benefit) at effective tax rate	**5,890**	**25**	(306)	(1)

31 December	2012	2011
Deferred income tax asset		
Tax loss carried forward	5,818	6,452
Pension liability	615	747
Fixed assets	510	14
Allowance for compensated absence	10	27
Onerous leases	12	11
Other	(225)	532
Deferred income tax asset	**6,740**	7,783
Less: valuation allowance	(5,378)	(1,110)
Net deferred income tax asset	**1,362**	6,673
Deferred income tax liability		
Other	-	(444)
Net deferred income tax asset	**1,362**	6,229

Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. A significant piece of objective negative evidence evaluated was the cumulative loss incurred in the UK bank over the three-year period ended 31 December 2012. Such objective evidence limits the ability to consider other subjective evidence such as projections for future growth.

On the basis of this evaluation, as of 31 December 2012, a valuation allowance of $5.4 million has been recognised to record only the portion of the deferred tax asset that more likely than not will be realised. The amount of the deferred tax asset considered realisable, however, could be adjusted if estimates of future taxable income during the carry forward period are reduced or increased, or if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as our projections for growth.

Operating loss and tax credit carry forwards

The Bank has net taxable losses carry forwards related to the Bank's international operations of approximately $23.4 million, which have an indefinite life.

(in thousands of Bermuda dollars)

Note 27: Related party transactions

Employee loan programme

As of 17 May 2005, the Bank established a programme to offer loans with preferential rates to eligible Bank employees, subject to certain conditions set by the Bank and provided that such employees meet certain credit criteria. Loan payments are serviced by automatically debiting the employee's chequing or savings account with the Bank. Applications for loans are handled according to the same policies as those for the Bank's regular retail banking clients. The Bank's ability to offer preferential rates on loans depends upon a number of factors, including market conditions, regulations and the Bank's overall profitability. The Bank has the right to change its employee loan policy at any time after notifying participants. The staff loans outstanding at 31 December 2012 amount to $225.7 million (2011: $251.9 million) resulting in an interest rate benefit to employees of $6.2 million (2011: $6.5 million).

Interested Director transactions

The Bank provides loans and other banking services to the Bank's Directors, as well as their immediate family members and companies with whom they are affiliated as described in Section 96 of the Companies Act 1981, in the ordinary course of business. The Bank provides these services on normal commercial terms in respect of interest rates, repayment terms and security.

During the third quarter of 2011 the Bank provided a loan to a trust company controlled by a Bank Non-Executive Director, amounting to $2.45 million. The terms of the loan are market related including comprehensive security provided. The outstanding loan was repaid during 2012.

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

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.

Liquidity facility agreement

During 2010, the Bank entered into a commitment letter for a $500 million line of credit at market rates with CIBC which was subsequently reduced to $300 million. The Bank cancelled the credit facility effective 1 March 2011.

Financial instruments with related parties

At 31 December 2012, the Bank held $125.3 million in cash and cash equivalents with CIBC. For the year ended 31 December 2012 the Bank held forward exchange contracts with CIBC with a notional amount of $284.1 million (unrealised gain of $1.0 million) and foreign currency deposit swaps with CIBC with a notional amount of $89.4 million (unrealised loss of $8.7 million). As noted in Note 16 the Bank enters into client service forward exchange contracts to meet the foreign exchange needs of its customers.

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 28: Comparative Information

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

Note 29: Subsequent Events

The Bank has performed an evaluation of subsequent events through to 26 February 2013. Subsequent to year end, the Board declared a special dividend of $0.04 cents per Common and Contingent Value Convertible Preference Share to be paid on 22 March 2013 to Shareholders of record on 5 March 2012.