ANNUAL REPORT
2005

BAHAMAS | BARBADOS | BERMUDA | CAYMAN ISLANDS | GUERNSEY | UNITED KINGDOM

Butterfield Bank

Butterfield Bank

Mission Statement

Butterfield Bank will provide consistent
and superior returns to our shareholders,
offer security and opportunities to our employees,
and be recognised as making a valuable contribution
to the communities in which we operate
by a customer focused, efficient and ethical delivery
of banking and other selected financial services.

Contents

Awards:

Awarded by Global Finance Magazine
Best Developed Market Bank in Bermuda
April 2005

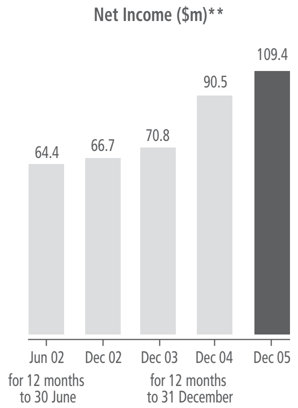
Bank of the Year 2005

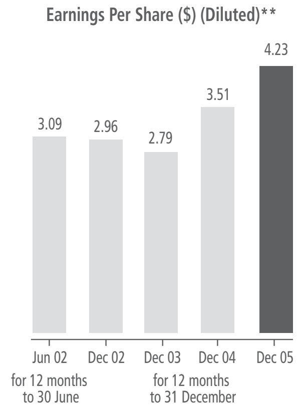
Awarded by The Banker Magazine
to Butterfield Bank in Bermuda
September 2005

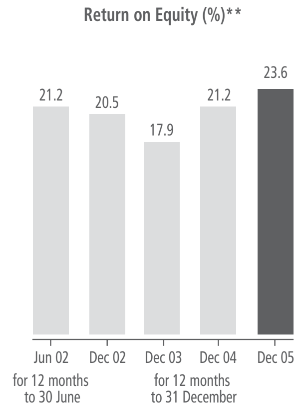
Financial & Statistical Summary

(In $ thousands except per share data)	Year ended **31 December 2005**	31 December 2004	31 December 2003	31 December 2002
				(unaudited)
Net income from continuing operations	**109,351**	90,466	70,838	83,743
Profit from discontinued operations	–	–	–	184
Net income	**109,351**	90,466	70,838	83,927
Diluted earnings per share				
Including discontinued operations	**4.23**	3.51	2.79	2.96
Excluding discontinued operations	**4.23**	3.51	2.79	2.96
At year end				
Total assets	**9,197,566**	8,630,383	7,733,806	6,007,874
Cash and deposits with banks	**2,849,920**	2,396,724	2,912,383	1,989,159
Investments	**2,916,399**	3,266,400	2,638,253	2,073,112
Loans	**3,085,594**	2,645,331	1,954,716	1,767,088
Deposits from customers	**7,948,966**	7,404,855	6,612,303	5,156,111
Deposits from banks	**291,143**	502,595	510,274	360,105
Subordinated capital and senior debt	**278,679**	142,333	122,871	75,000
Shareholders' equity	**495,226**	428,030	382,095	338,799
Net book value per share	**19.48**	17.13	15.30	13.68
Market value per share	**46.60**	36.82	36.36	25.21
Number of shares (in thousands)*	**25,429**	22,745	20,643	18,603
Number of shareholders	**3,878**	3,778	3,581	3,322
Number of employees	**1,597**	1,552	1,381	1,200
Financial ratios				
Return on assets**	**1.2%**	1.1%	1.0%	1.2%
Return on shareholders' equity**	**23.6%**	21.2%	17.9%	20.5%
Total capital funds to total assets ratio	**8.4%**	6.6%	6.5%	6.9%

* Excludes shares held by the Bank's Stock Option Trust.
** Excludes discontinued operations and gain on sale of subsidiaries.
Comparative per share data has been restated to reflect the 1 for 10 stock dividends in August 2005, 2004 and 2003.
Data for 2005, 2004 and 2003 is shown under US GAAP and for 2002 under Canadian GAAP.
All percentages here and in the report that follows are based on actual rather than rounded numbers.







Corporate Profile

The Butterfield Bank Group is a full service community bank and a provider of specialised offshore financial services. Our headquarters and largest operations are in Bermuda, where we were established in 1858 as the island's first bank and continue to play an important role in the local economy. With additional operations located in The Bahamas, Barbados, the Cayman Islands, Guernsey and the United Kingdom, we have $9.4 billion of assets under management and over $102 billion of client assets under administration.

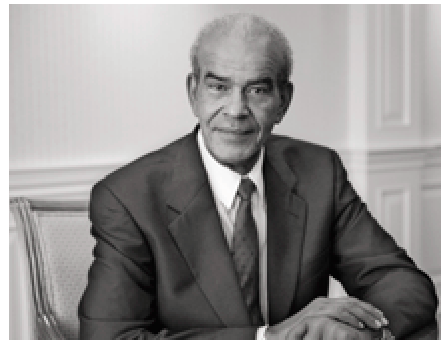
We provide a full range of community banking services for institutional and individual customers in Barbados, Bermuda and the Cayman Islands, encompassing retail and corporate banking and treasury activities. As a specialist offshore financial services group, we also provide private banking, wealth management and fiduciary services, and institutional and pension fund administration in The Bahamas, Bermuda, the Cayman Islands, Guernsey and the United Kingdom. Our success is built on a set of fundamental strengths: sound corporate values, a stable customer base, strong liquidity and capital positions, and solid core businesses.

Our home country regulator is the Bermuda Monetary Authority, which operates in accordance with Basel principles and maintains close contacts with regulators in the other jurisdictions where we have offices. Our common stock is listed on The Bermuda Stock Exchange and the Cayman Islands Stock Exchange. We have over 3,800 shareholders with 26.9 million shares outstanding.

Our performance is a direct result of the efforts of our dedicated employees who work together to deliver quality financial services, build business and enhance shareholder value. At 31 December 2005 we had a total of 1,597 employees, 789 in Bermuda and 808 overseas.

We believe that a positive work environment, with effective employee training, development and communication, benefits our customers through quality service, and our shareholders through long-term improvements in results.

Involvement in the communities in which we operate is important to the Butterfield Bank Group. We support a variety of projects and organisations that invest in areas such as youth development, healthcare, social causes, sports, heritage and the arts. Our educational scholarships and bursaries help young people fulfil their potential and achieve their dreams. We take an active role in community events and encourage the efforts of the many employees who give their own time and energy to a multitude of charitable causes. Collectively and individually, we take action to make our communities better.



Chairman's Letter to the Shareholders

On behalf of the Board of Directors, it gives me great pleasure to report that the Butterfield Bank Group has again delivered impressive results at a time of challenging global economic conditions. The year ended 31 December 2005 saw the Group continue to achieve substantial strategic and financial growth.

The Strategic Review approved by the Board in 2003 was updated in 2005 and continues to provide a sound vision for the Group's future: a commitment to building and judiciously expanding our core businesses. The figures for 2005 once again demonstrated the strength of this proven business model in consistently producing solid financial results and continuing to build shareholder value.

The acquisitions made by the Group in the United Kingdom, The Bahamas and Bermuda in 2004 have now been successfully assimilated into our core businesses and are beginning to contribute to the Group's revenues. As we move into 2006 the Group can now focus on building on this strong foundation in line with our strategic plan. The Group is now well positioned to offer first class seamless multi-jurisdictional solutions and products to our increasingly diverse and sophisticated customer base.

For the third year running the Board approved a one-for-ten bonus share issue, which was distributed to shareholders in August 2005. This bonus equated to a 10% stock dividend and combined with the 12-month cash dividend of $1.67 per share once again gave shareholders an impressive return on their investment.

In closing, I wish to express my sincere gratitude to the Group's management team and employees for their expertise, dedication and commitment which has produced these impressive results.

I also thank our shareholders and customers for their continued support. In today's highly competitive environment the Board values your loyalty and pledges to continue working to earn the trust placed in us.

James A.C. King

James A.C. King, JP
Chairman of the Board

President & Chief Executive Officer's Report

I am pleased to report that in 2005, the Butterfield Bank Group delivered solid financial results. The Group's net income for 2005 was $109.4 million, an increase of 20.9% on last year with a return of 23.6% on shareholders' equity. These results reflect the strength of the Bank's core businesses that underpin our balanced, international business model.

We were particularly pleased with the performance of our Cayman operations this year in making a full recovery from the damage inflicted on their infrastructure by Hurricane Ivan in 2004. In addition we continue to be very satisfied with the progress made by our operations in The Bahamas and Barbados. This year marked the first full 12 months of operation with Leopold Joseph Holdings plc, which we acquired in April 2004. We continue to be pleased with the success of the integration of Leopold Joseph into our UK and Guernsey operations and the improved financial performance as well as the quality of service it now enables us to offer our clients.

Our financial results in 2005 continue to reflect the balance and soundness of the Group's business model with approximately 70% of our revenues being generated from banking business lines and 30% from fund administration, trust, asset management and related areas. Interest income represents approximately half of our revenue with the balance generated from fees and customer generated foreign exchange earnings. We believe this balance to be one of the Group's fundamental strengths. The increasingly international nature of our business will be reflected in a product line approach for Butterfield Asset Management and Butterfield Fund Services which will leverage our specialist strengths across all the Group's jurisdictions to better serve our customers.

Superior customer service is critical in today's competitive banking environment, and continually improving the customer experience remains a priority across the Group. For example, we continued to focus on our Service Initiative Training programme, launched in Bermuda in 2004.

We continue to be closely involved in all the communities in which we operate. We consider it our duty and responsibility to support a wide range of local causes, events and organisations both financially and through direct involvement of our employees.

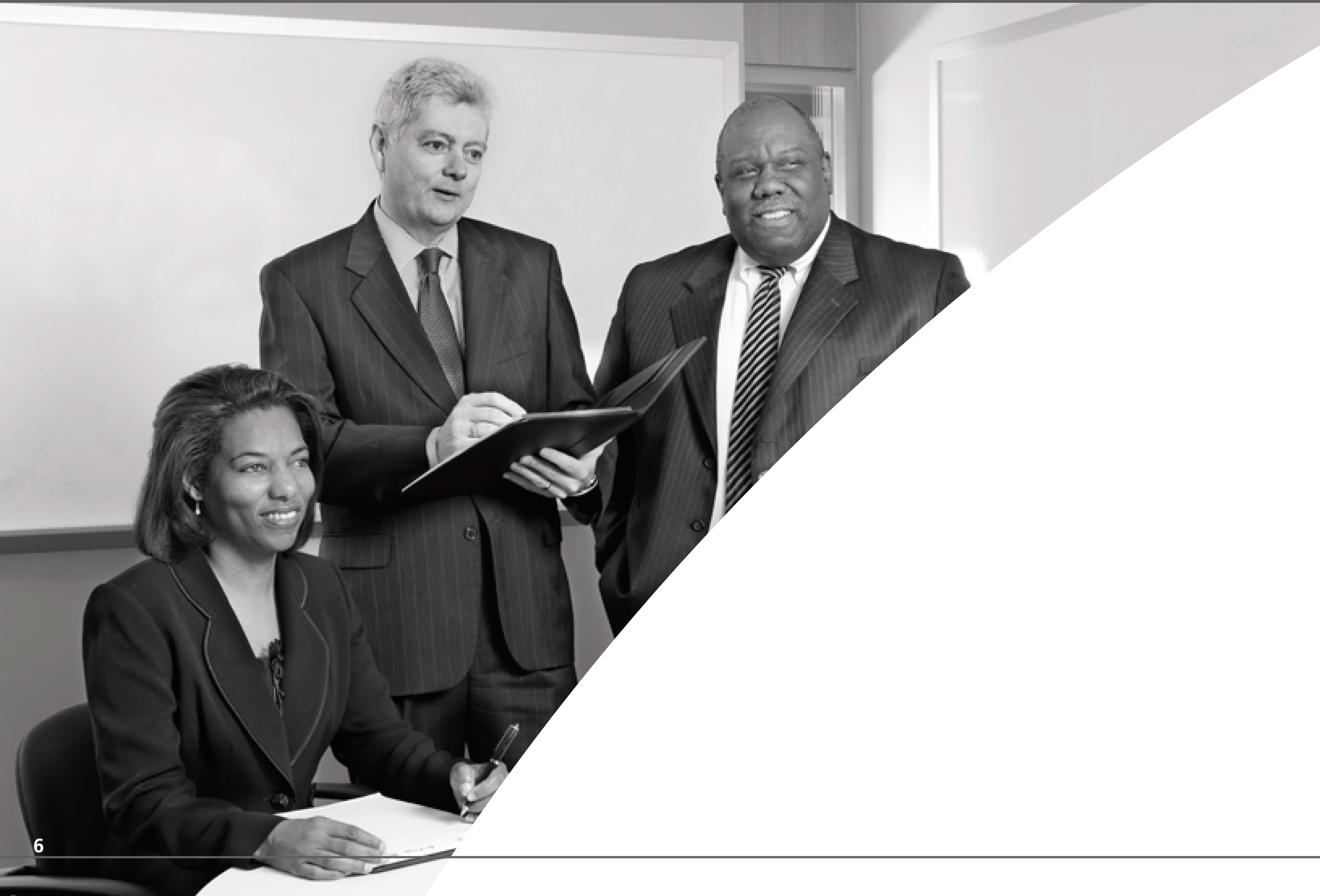
On behalf of the management team, I once again wish to express my appreciation to the Board of Directors for their continued support, advice and oversight. I would also like to thank our employees, shareholders, customers and business partners for their valuable contributions to another successful year.

Alan R. Thompson
President & Chief Executive Officer

Management's Discussion and Analysis of Results of Operations and Financial Condition[1]

From left to right:

Sheila M. Brown Senior Vice President, Investment Services
Michael O'Mahoney Senior Vice President, Treasury
W. Aaron M. Spencer Senior Vice President, Operations



From left to right:

Graham C. Brooks Executive Vice President, International
Richard J. Ferrett Executive Vice President, Chief Financial Officer
C. Wendell Emery Executive Vice President, Operations & Information Technology
Peter J.M. Rodger Senior Vice President & Group Legal Adviser, Secretary to the Board

Results of operations for the year ended 31 December 2005 compared with the year ended 31 December 2004.

The Butterfield Bank Group[2] achieved net income of $109.4 million for the year ended 31 December 2005, representing a 20.9% increase in net income over the same period last year. The Group's performance was supported by the successful integration of acquisitions made in 2004, including Leopold Joseph's businesses in the UK and Guernsey, which began to perform in line with expectations. This resulted in increased net income from outside Bermuda. The Bermuda businesses represented 48.3% of Group net income in 2005, compared to 75.9% in 2004. Across all Group operations, including Bermuda, a solid overall performance was achieved.

Net interest income was a record, at $185.3 million before credit related provisions. Up year on year by 22.8%, the increase reflects balance sheet growth, a 16.6% increase in the loan portfolio and higher US interest rates, which rose eight times in 2005 to 4.25%. Non-interest income also increased year on year by $15.6 million, or 10.0%, to $172.1 million, reflecting strong growth across all revenue lines.

The Group's balance sheet remains highly liquid, with a loan to customer deposits ratio of 38.8%. Customer deposits increased significantly by 7.3% year on year to $7.9 billion, reflecting growth in Cayman, up $219 million, the United Kingdom, up $122 million, and Bermuda, up $57 million.

Loan portfolio growth of 16.6% to $3.1 billion across the Group's operations reflected our ability to meet new demand for lending products, with Bermuda's community banking business up 20.5%, the United Kingdom up 9.7% and Guernsey up 16.6%.

Non-performing loans totalled $27.0 million at year-end 2005, representing 0.9% of total loans, compared to 0.8% a year ago.
As at 31 December 2005 the general allowance for credit losses of $20.6 million was equivalent to 0.7% of total loans. A specific allowance of $4.1 million is held for possible shortfalls in the security held for non-performing loans. In total the allowance for credit losses is $24.7 million, or 0.8% of the loan portfolio. Delinquency and charge-off ratios continued to be well below industry average.

[1] Management's discussion and analysis of results of operations and financial condition should be read in conjunction with the Group's Consolidated Financial Statements, beginning on page 26, and the notes to those financial statements, which begin on page 30. These statements and notes have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP).

[2] All references to the Butterfield Bank Group or "the Group" refer to The Bank of N.T. Butterfield & Son Limited and its subsidiaries on a consolidated basis.

Management's Discussion and Analysis of Results of Operations and Financial Condition

Shareholder Value
Sustained strong performances have enabled the Group to continue building shareholder value and, for the third consecutive year, a 'one for ten' bonus share issue was made in August 2005. This equates to a 10% stock dividend. Additionally, for the fourth quarter the Board approved a dividend increase of 3 cents, resulting in a total dividend for 2005 of $1.67 per share, an increase of 12 cents, or 7.7%, over last year. The cash dividend paid to shareholders in 2005 was $38.5 million, up 19.5% on the previous year and represents a 35.2% payout on net income for the period. The increase in shareholder value for the year, defined as the increase in share price plus dividends reinvested, was 31.4%.

Share Purchase Activity
Under the Share Buy-back Plan, during the year 32,890 shares were repurchased and cancelled at an average cost of $41.46 per share. In addition, the Stock Option Trust bought 285,854 shares at an average cost of $44.10 per share to satisfy the Bank's obligations with respect to the Stock Option Plan.

Performance Indicators
The Group's overall strength and performance are indicated by certain key measures. Return on shareholders' equity was 23.6% for the period, up from 21.2% in 2004. Diluted earnings per share was $4.23, up 72 cents, or 20.5% compared with $3.51 last year.

The Group's efficiency ratio, which is operating expenses (excluding corporation tax and amortisation of intangible assets) expressed as a percentage of operating income (excluding credit provisions and gain on sale of subsidiaries and affiliates), saw a year on year improvement, from 69.1% the previous year to 66.4% in 2005.

From left to right:

Lloyd O. Wiggan Senior Vice President, Retail Banking
James R. Stewart Senior Vice President, Enterprise Risk Management
Ian M. Coulman Managing Director, Butterfield Asset Management
Andrew R. Collins Managing Director, Butterfield Fund Services (Bermuda) Limited

From left to right:

Michael A. McWatt Senior Vice President, Credit Risk Management
Bob W. Wilson Senior Vice President, Corporate and Private Banking
Donna E. Harvey Maybury Senior Vice President, Human Resources

Jurisdictional Overview

From left to right:

Graham M. Jack Managing Director, Butterfield Trust (Bermuda) Limited
Pete D. Ramsdale Senior Vice President, Chief Information Officer
Fred H. Tesch Senior Vice President, Group Internal Audit

The Bahamas

Robert V. Lotmore
Managing Director

Butterfield Bank (Bahamas) Limited

The Group's Bahamian operations provide private banking, wealth management and fiduciary services and investment and pension fund administration through Butterfield Bank (Bahamas) Limited and Butterfield Fund Services (Bahamas) Limited.

Total net income for The Bahamas in 2005 increased by 147.8% to $1.7 million from $0.7 million in 2004. At 31 December 2005 total assets in The Bahamas were $96.9 million, an increase of 52.8% from $63.4 million the previous year. Total assets under administration in The Bahamas stood at $4.0 billion at year-end.

Butterfield Bank (Bahamas)
Butterfield Bank (Bahamas) Limited provides a premier service, administering tailored solutions for international, high net worth and corporate clients with wealth management needs. Areas of expertise include private banking, fiduciary services and global custody.

During the year much focus was placed on business growth and on enhancing the Group's Bahamas presence locally and internationally. Led by private banking, Butterfield Bank (Bahamas) saw strong growth, with international recognition gained through targeted marketing efforts. At 31 December 2005 the total lending portfolio had increased by 78.3%, or $2.3 million, year on year to $5.2 million, due in part to the Bank's mortgage product.

Butterfield Fund Services (Bahamas)
Butterfield Fund Services (Bahamas) Limited is a specialist provider of administration services to the investment and pension fund industry. It offers Net Asset Value ("NAV") calculations, accounting, corporate and shareholder services to alternative investment, hedge, mutual and pension funds. The introduction of innovative products like SMART Funds, which are regulated vehicles for investment funds, and the support of The Bahamas' progressive investment fund legislation, introduced in 2003, have assisted growth in 2005. Total assets under administration at 31 December 2005 were $2.4 billion.

Barbados

Mariano R. Browne
Managing Director

Butterfield Bank (Barbados) Limited

The Group's Barbados operations provide a comprehensive range of banking services through Butterfield Bank (Barbados) Limited, a full service community and commercial bank. A separate entity, Butterfield Asset Management (Barbados) Limited, acts as a representative office for the Group's investment business.

Total net income for Barbados in 2005 was $1.4 million, an increase of $1.1 million from 2004. This reflects a significant increase of 29.4% in loan growth, improvement in the quality of the loan portfolio that reduced provisions for loan losses by $0.5 million year on year, and a rising interest rate environment. At 31 December 2005, total assets in Barbados were $194.4 million, an increase of 12.2% from $173.3 million in 2004.

Butterfield Bank (Barbados)
Butterfield Bank (Barbados) Limited is headquartered in the commercial centre of Bridgetown, the capital city, with three other branches in commercial and suburban areas. The Bank's range of community banking services includes personal and commercial loans, overdraft facilities, credit cards, ATMs, merchant and e-commerce facilities, and fixed deposit, chequing and saving accounts.

The Bank has successfully established itself in the Barbados market by providing consistently high levels of customer service and offering products to meet the needs of the local community.

In 2005, the total lending portfolio grew by $24.9 million to $109.5 million. Residential mortgages introduced in 2004 are now a significant portion of the loan portfolio amounting to 30.3% of total loans. Investments increased by 53.7% to $64.5 million and customer deposits grew 14.9% to $159.4 million.

Butterfield Asset Management (Barbados)
Butterfield Asset Management (Barbados) Limited acts as a local representative for the Group's investment business services, meeting the asset and cash management needs of captive insurance companies, international businesses, trusts and private clients.

Bermuda

The Group's Bermuda operations provide community banking, asset management, trust and investment and pension fund administration services through The Bank of N. T. Butterfield & Son Limited under the Butterfield Bank brand and its wholly owned subsidiaries: Butterfield Asset Management Limited, Butterfield Fund Services (Bermuda) Limited and Butterfield Trust (Bermuda) Limited.

Home to the Group's headquarters and largest operations, Bermuda continued to deliver a solid financial performance in 2005. This performance was recognised by The Banker magazine, which named Butterfield Bank as Bermuda's Bank of the Year for the fourth consecutive year and by Global Finance Magazine which awarded the Bank Best Developed Market Bank in Bermuda. To improve the all-round customer experience, premises continued to be refurbished and, as part of our service programme, service training took place for over 80% of employees in the jurisdiction.

In 2005, total revenues for the Bermuda operations increased by $13.9 million, or 7.4%, to $200.1 million when excluding a $5.8 million realised gain in 2004 from the sale of a venture capital investment. The year also saw a 35.6% increase in assets under administration, up $11.9 billion to $45.2 billion. Operating expenses increased by 19.4% in 2005, reflecting investment in people, technology and risk management, and the increasing cost of health care in Bermuda.

Butterfield Bank
Working under the brand of Butterfield Bank, the Group's community banking operations in Bermuda comprise corporate, private and retail banking and treasury services. In 2005, these businesses achieved a 5.8% year on year increase in total revenues before provisions for credit losses, and excluding the above realised gain in 2004. Net interest income was up 13.0% to $106.9 million, reflecting strong loan growth and a 6.8% increase in average interest earning assets to $4.0 billion. Net income in 2004 was driven up by a significant one-off loan recovery and investment gain. This has impacted the year on year net income comparison for 2005, which fell to $28.1 million, despite solid revenue increases across the community banking businesses.

Retail Banking saw substantial growth during 2005, especially in the areas of residential mortgage and personal lending, which increased year on year by 13.1% to $0.9 billion. Debit and credit card business continued to grow aggressively, with the Butterfield/AAdvantage© MasterCard® credit card portfolio showing impressive growth during its first full year. This new credit card now represents 49.1% of total personal credit card expenditures at year-end 2005. Overall, credit card outstandings grew 11.8% year on year.

Investments in electronic banking included a complete upgrade for the Island's Butterfield Direct ATM network, with all ATMs being replaced. Additionally, free security tokens were introduced to protect the growing number of corporate and individual customers using the Bank's online banking service, Butterfield Direct Internet Banking, from potential internet fraud. Their introduction set a new standard of security for online banking in Bermuda, with the security tokens being recognised by banks around the world as providing one of the most secure log-in processes.

The growth of Corporate Banking in 2005 exceeded expectations with the loan portfolio growing by 28.0%, to $1.1 billion. In excess of $400 million was written in new loans. This strong performance reflected a buoyant local economy, close relationships with customers and an ability to execute opportunities quickly and efficiently. A highly selective approach to corporate lending maintained loan quality and the diversity of the portfolio. Letters of Credit business reduced slightly due to a falling demand in the market although fee income held up reasonably well.

Private Banking continued to grow during 2005 by maintaining its focus on building long-term relationships with high net worth clients. The business will be moving in 2006 to the former

Bermuda Monetary Authority Building in Hamilton which was purchased by the Group in 2005 and is currently undergoing refurbishment. To be called Butterfield House, the new offices will enable Private Banking to offer clients greater privacy and improved services.

Butterfield Trust (Bermuda)
Providing a comprehensive range of trust, estate and company administration, company management and custody services, Butterfield Trust (Bermuda) Limited (BTBL) focuses on local and international clients, both corporate and individual. BTBL's operations comprise Trust Administration Services and Investment Services. Grosvenor Trust Company Limited, a wholly owned subsidiary of BTBL that was acquired in the last quarter of 2004, was successfully integrated in 2005 within Trust Administration Services, although Grosvenor's identity has been retained. BTBL reported 2005 net income of $7.3 million, an increase of 8.7% over 2004.

Net income from Trust Administration Services was $4.1 million, slightly down from $4.2 million in 2004 reflecting the lower level of estate fees earned. Personal trust business continued to expand, attracting families who value the flexibility and independence provided by BTBL's customised services when managing their financial affairs in today's increasingly regulated international environment.

Supporting Butterfield Trust and the Bank, the Investment Services department provides comprehensive custodial services including safekeeping of assets, trade settlement, income collection, funds transfer and capital reorganisation processing. In 2005 Investment Services enjoyed a record year with net income of $3.2 million, up 25.1% on 2004, and completed major upgrades of its core record-keeping and payments systems. The year saw a 28.2% increase in total revenues, to $9.8 million, driven by significant growth in external trust company and mutual funds business. At year-end, the department had $17.8 billion in assets under custody, up from $17.5 billion the previous year.

Butterfield Asset Management
Butterfield Asset Management Limited (BAM) provides discretionary and advisory investment management and brokerage services to a wide range of individual investors and organisations, and manages the family of ten Butterfield Funds as well as the Group's investment portfolios.

BAM reported 2005 net income of $14.1 million, an increase of 4.9% over 2004. Assets under management by BAM, including client assets invested in Butterfield Funds, rose by $0.1 billion to $7.6 billion. The year again saw significant growth in Butterfield Select, BAM's Fund of Funds product, which rose by 31.3% to $342.7 million and the Butterfield Liquid Reserve, which rose 19.5% to $522.5 million.

In Bermuda, BAM's strong performance was driven by its consistent proven investment strategy and by actively marketing wealth management services to private clients, trust companies and intermediaries. Having launched a new web site early in 2005, BAM also continued to develop close relationships with the insurance industry and co-ordinated the Bank's platinum level sponsorship of the first Bermuda Captive Conference.

In April BAM's Butterfield Select Fixed Income Class fund won the Standard & Poor's (S&P) award for the best three-year performance of a US Dollar offshore fixed income fund. Continuing to innovate to meet customer's investment needs, BAM launched two new products in 2005. The Butterfield Guaranteed Equity Deposit offered investors a guaranteed six-year fixed term deposit with Butterfield Bank, while the Butterfield Select Invest Fund provided investors with an easy and affordable way to invest, with exposure to more than 50 internationally-recognised funds for a minimum investment of only US$1,000.

Butterfield Fund Services (Bermuda)
Butterfield Fund Services (Bermuda) Limited (BFS Bermuda) provides valuation, accounting, corporate and shareholder services to offshore hedge funds, pensions and mutual funds. It acts for a number of the world's leading investment management groups as well as accounting for the Bank's portfolio of assets, the share register of the Group and administering the Butterfield family of funds.

For the year ended 31 December 2005 net income was $9.5 million, up 32.9% compared with $7.2 million the previous year, reflecting another year in which BFS Bermuda significantly increased its client base. Net assets under administration, excluding the Butterfield Funds, increased by 58.7% from $16.7 billion in 2004 to $26.5 billion as at 31 December 2005.

Cayman Islands

Conor J. O'Dea
Managing Director
Butterfield Bank (Cayman) Limited

The Group's Cayman operations offer a comprehensive range of services to the local and international market through Butterfield Bank (Cayman) Limited and Butterfield Fund Services (Cayman) Limited. They provide community and commercial banking services, investment management, custody, trust and company administration, and investment and pension fund administration services. Butterfield Bank is currently the largest private sector employer in financial services in Cayman. The number of employees increased from 273 in 2004 to 317 in 2005 reflecting growth in all business divisions. The Bank continued to develop comprehensive training and employment programmes in Cayman and remains committed to providing quality career growth and educational opportunities for ambitious young Caymanians.

In 2005, the Cayman operations continued to play a leading role in the Islands' recovery from the devastation caused by Hurricane Ivan in September 2004, and the Bank's services and community involvement were key factors in rebuilding Cayman's physical and economic infrastructure during the year. Butterfield Bank sponsored and hosted a Cinema Premiere of "36 Hours in September", a Hurricane Ivan documentary benefiting the Cayman Islands National Recovery Fund that we had helped launch in 2004.

Net income was $45.8 million, up 85.3% over 2004, which represents a return on equity of 33.0%, up from 20.2% in 2004. Net interest income before provisions for credit losses was up 42.7% on 2004 at $44.1 million, while non-interest income totalled $36.5 million, an increase of 26.1% on 2004. Total income was up 46.1%, or $25.9 million to $82.2 million. The efficiency ratio saw a significant improvement, from 52.7% in 2004 to 45.2% and the net interest margin widened by 0.7% to 2.4%. Total assets increased year on year from $2.3 billion to $2.6 billion, reflecting continued growth in customer deposits. Total assets under administration at 31 December 2005 were $31.7 billion, up 26.5% from $25.0 billion at year-end 2004.

Butterfield Bank (Cayman)
The Bank continued to achieve solid growth and increased market share in its community and commercial banking services. Revenues were driven by a rise in interest rates, robust foreign exchange commissions and ongoing investment in technology to enhance customer services through ATM and internet banking. Revenues from banking services increased 21.2% year on year, up $1.3 million to $7.6 million, while foreign exchange revenues rose $2.4 million, or 32.4%, to $9.7 million.

The Cayman Islands' economy has been extremely robust over the past year. This is mainly attributed to post-Ivan rebuilding as well as new developments in the real estate market. By successfully managing its loan portfolio after Hurricane Ivan the Bank was able to release some of the Ivan-related credit loss provisions that were set aside. As a result, there was a $1.6 million net release of provisions for credit losses in 2005, compared to a charge of $3.6 million the previous year. Investment and Custody services experienced good revenue growth increasing by 14.5% to $5.2 million.

During 2005, ground was broken on the Bank's new headquarters, Butterfield Place, which will be a showcase building and is due for completion in 2007. The development will be the first seven storey building in George Town, designed to the highest standards and comprising 60,000 square feet of office space together with a six-level parking garage.

Butterfield Miles, the loyalty programme with Cayman Airways, earned customers over six million air miles in its first year. The programme awards Bank customers free air miles on the national flight carrier every time they make a purchase with their Butterfield Bank VISA Gold credit card. An innovative service for prepaid mobile phone customers, "iTopUp with Butterfield", was introduced by Butterfield Bank (Cayman) in April 2004. Through this service prepaid telecom customers can "top up" their phone balance using any local debit card at all Butterfield Bank ATMs. The service has seen significant growth in volume since its introduction.

Butterfield Fund Services (Cayman)
Butterfield Fund Services (Cayman) Limited (BFS Cayman) provides investment and pension fund administration services. BFS Cayman took on the administration of 49 new hedge funds in 2005. Revenues rose from $8.1 million in 2004 to $10.1 million, up 24.9% year on year. BFS Cayman now has 50 employees, up from 35 last year.

Guernsey

Robert S. Moore
Managing Director
Butterfield Bank (Guernsey) Limited

The Group's Guernsey operations offer private banking, wealth management and fiduciary services, administered banking services, and investment and pension fund administration services. These services are offered through Butterfield Bank (Guernsey) Limited, Butterfield Trust (Guernsey) Limited and Butterfield Fund Services (Guernsey) Limited.

A positive international economic environment and generally strong investment market conditions provided a supportive backdrop for the Guernsey operations in 2005. Pre-tax net income in Guernsey increased from $2.2 million in 2004 to $8.2 million. Post-tax net income was increased from $2.6 million in 2004 to $7.2 million. In 2004 a tax credit of $0.4 million was recognised, compared to a tax expense of $1.0 million in 2005. Total revenues in Guernsey rose by 14.5% to $40.1 million. Private client business, including deposit and loan volumes, grew strongly and the benefits of the acquisition of Leopold Joseph Guernsey in 2004 also impacted positively on operating profits. Institutional client business registered high growth levels on all fronts, including fund administration, custody services and administered banking services.

Total assets under administration in Guernsey stood at $20.2 billion, an increase of 23.0% from 2004.

Butterfield Bank (Guernsey)
Butterfield Bank (Guernsey) Limited provides quality banking services tailored to the needs of private and institutional clients.

Customer deposits increased by 4.5% to $1.4 billion, while loans outstanding at 31 December 2005 stood at $214.9 million, an increase of 16.6% from 2004 with good growth both in property-related lending and in facilities collateralised by securities portfolios. Net interest income increased by 40.1% to $12.6 million, while banking and foreign exchange fees and commissions increased by 13.3% to $11.4 million. Total assets under management, primarily for high net worth individuals and families, stood at $869 million, an increase of $15 million year on year.

Guernsey continued to be a market leader for administered banking – the provision of outsourcing solutions such as operational, accounting, compliance and corporate secretarial services – for Guernsey branches and subsidiaries of leading international banks and other financial institutions. This business line saw further growth in 2005, with assets under administration increasing by 29.2% to $7.1 billion.

Custody Services also registered strong business growth. Institutional custody clients, including sponsors of both Guernsey and non-Guernsey regulated investment funds, continue to be attracted by the combination of technical expertise and high quality service that the Bank offers. Custody assets under administration increased more than 100% in 2005, by $2.6 billion to $5.1 billion.

Butterfield Trust (Guernsey)
Fiduciary services offered by Butterfield Trust (Guernsey) Limited include tailored trust and company administration services for institutional families, and sophisticated structures for corporate and institutional clients. The latter includes employee benefit trusts, and outsourcing support for the investment management, finance company and trust company operations of leading financial services companies.

Butterfield Fund Services (Guernsey)
Butterfield Fund Services (Guernsey) Limited provides a full range of administration services to offshore funds of hedge funds, property funds and other specialist investment funds. It is the jurisdiction's largest specialist in administration of Cayman and other non-Guernsey funds. In partnership with other companies in the Group it also provides administration solutions for family offices. Total assets under administration at 31 December 2005 stood at $6.6 billion, up from $6.1 billion a year ago.

The United Kingdom

Paul A. Turtle
Managing Director

Butterfield Bank (UK) Limited

The Group's UK operation offers a full private banking service targeting high net worth individuals and their families with interests in the UK who are either UK or non-UK residents, through Butterfield Bank (UK) Limited, under the brand of Butterfield Private Bank.

The acquisition of Leopold Joseph Holdings plc in 2004 has impacted earnings positively. Total revenues for the UK in 2005 increased by 16.8% to $22.6 million. A post-tax loss of $0.3 million was recorded, compared to a loss of $7.2 million in 2004. The loan portfolio in the UK increased by 8.6% to $423.2 million, while customer deposits increased year on year by 15.0% to $929.1 million. Total assets in the UK increased year on year by 22.7% when expressed in sterling terms, reflecting strong growth in customer deposits. However, due to the UK pound weakening by 10.3% during 2005, when expressed in dollar terms the growth reduces to 10.0%, with total assets ending the year at $1.2 billion.

A key element of Butterfield Private Bank's strategic direction includes involvement with the pensions market for high earners in the UK. During the year substantial progress was made to become one of the UK's major providers of Self Invested Personal Pensions (SIPPs). From April 2006, higher annual levels of pension contributions will be permitted and the range of investments allowed will also be expanded. Butterfield Private Bank provides full banking services for SIPPs, lending to assist gearing within SIPPs to purchase commercial property and full discretionary investment management for the pension fund.

To identify clients looking to extend business activities or investments in the UK, Butterfield Private Bank works closely with professional financial advisors in the UK and other Group offices.

The Bank has continued to strengthen its ability to meet the financial service requirements of high net worth clients through integrated services comprising high interest deposit banking, lending for residential and commercial property investment and discretionary investment management. Its Family Office offers a more holistic-based approach to meeting the needs of high net worth individuals and their families.

With a distinctive approach to investments and the abilities and discretion of its financial advisors, Butterfield Private Bank has a solid platform and an advantage in a highly competitive market.

Group Business Lines & Support Divisions

Group Asset Management

Bruce Albrecht
Senior Vice President

Group Head of
Asset Management

The Group's Asset Management businesses provide investment management and brokerage services to institutional and private clients from The Bahamas, Barbados, Bermuda, Cayman, Guernsey and the UK. In 2005, Asset Management strengthened its senior management team by appointing a Senior Vice President, Head of Group Asset Management. The creation of this new position reflected the increasingly significant role that the Asset Management businesses play across the Group and the importance of developing it as a consistent offering to clients going forward.

In 2005, Group revenues from Asset Management were $34.7 million, up 20.8% on $28.7 million in 2004. Group Assets under Management at year end 2005 were $9.4 billion.

Group Fund Services

Frank J. Sebestyen, III
Senior Vice President

Group Head of
Fund Services

From 2006, we will be working to more closely integrate our fund services businesses across jurisdictions under a Senior Vice President, Head of Group Fund Services. Fund Services specialises in providing third party administration for investment and pension funds in Bermuda, The Bahamas, the Cayman Islands and Guernsey and acts for a number of the world's leading investment management groups. The international client base serviced by Fund Services, along with the desire to seek efficiencies, make a more cohesive approach a natural progression for the business.

Across all four jurisdictions, Fund Services employs over 200 employees, has assets under administration in excess of $61 billion, and provides full administration services to over 750 mutual and hedge funds.

Human Resources

While complying with local regulations and employment law in its different jurisdictions, the Group has an over-riding philosophy with regards to retaining and attracting quality people. Embracing a 'total rewards' approach, the Group aims to create an all-round rewarding and service-oriented environment. In 2005 this has meant improving premises, having competitive and meaningful benefits, recognising and rewarding performing employees and investing in training and development for employees.

The Group provides ongoing training and development opportunities for all its employees, co-ordinating and facilitating programmes ranging from technical skills to personal and professional development. The programmes help maintain the Bank's high quality of customer service, enhance the workplace experience and ensure that Butterfield Bank remains a competitive employer in all its jurisdictions.

Technology

The Group is moving towards a common approach to technology and finding areas of synergy across different jurisdictions and businesses that often require different systems. In 2005, investment in technology has helped streamline the Group's operations and support the delivery of new products and services. In Bermuda, the project to replace the core banking system has progressed with the software having now been received in preparation for a 2006 implementation.

2005 also saw the commencement of a project to develop a single Butterfield Bank Group website. This is a critical development that will enable the Group to provide additional capabilities as customer demand for access to information and online transactions continues to rise. During the year, work was also completed on developing the Group's Financial Systems Roadmap – a key activity in order to build capabilities in Bermuda and standardise across the Group.

Risk Management

Risk is inherent in virtually all of the Group's daily activities and, as such, managing risk is a cornerstone of our business. Established risk management structures, policies and procedures are in place to identify, prioritise and manage risks across the Group in order to develop businesses with an appropriate balance between risk and reward.

The three key risk types faced by the Group are credit risk, market risk and operational risk. Credit Risk is the risk of loss associated with the failure of a borrower or counterparty to fulfil its financial or contractual obligation to the Bank. The Group manages its credit risk through comprehensive governance and management processes, including established credit policies, guidelines and clearly defined credit authorities. The Group Credit Committee, chaired by the President & Chief Executive Officer, provides a forum to review credit exposures, establish and review credit policies and approve selected credit transactions for the Group.

The Enterprise Risk Management (ERM) function identifies, manages and reports on all types of risk by business line or process. ERM identifies and assigns ownership for market and operational risks, develops risk priorities, approves appropriate mitigation strategies, and examines the cause-and-effect relationships between individual product risks. It also ensures that adequate and comprehensive risk data are available to support decision-making and that risk reporting is effective, reliable and timely.

The Risk Review Committee, chaired by the Head of Enterprise Risk Management, also reviews and monitors business/event risks, insurance coverage, transactions and operational controls, operating losses and frauds, business continuity, potential regulatory changes, legal risks and compliance with financial and business conduct regulations. The Board's Audit and Compliance Committee reviews internal audit, compliance and litigation reports.

Market risk and liquidity risk are managed through appropriate controls and reporting systems. The Asset and Liability Management Committee (ALCO), chaired by the Chief Financial Officer, and the Risk Policy Committee of the Board of Directors play an integral role in identifying, reviewing and managing financial and operational risk.

Operational risk refers to the risk of loss caused by internal or external events such as procedural failures, errors or fraud. We mitigate this risk through the application of properly risk-adjusted internal controls, sound business processes, good decision-making, effective project execution and risk transfer techniques.

The Group successfully addressed several incidents throughout the year in several of its jurisdictions. During the island-wide power outage in Bermuda in July, Butterfield Bank was one of the few Hamilton businesses that were able to remain open and continue to serve its customers. Full disaster tests were conducted in respect of two major operations over the year with positive results.

The Compliance function within ERM, seeks to ensure the Group is adequately safeguarded from criminals and fraud. Undertaking Know Your Customer research, monitoring of account activity, working with regulators and assisting with criminal investigations, Compliance is an integrated part of the Group's business processes.

The Group Internal Audit function is independent from the Group's day-to-day operations, and has access to all activities conducted by the Group, including those of its branches and subsidiaries.

Income

Total income for the Group after provisions was $355.1 million for the year ended 31 December 2005, up $44.0 million, or 14.1% from $311.2 million for the same period a year ago. Net interest income before provision for credit losses increased by 22.8% to $185.3 million. The increase reflects growth in average interest earning assets, which was up 11.6% to $8.8 billion, and the Group's continually successful asset/liability management strategies. As a result the net interest margin widened by 0.2% to 2.1% and the interest rate spread increased by 0.1% to 1.7%.

The Group continues to be appropriately reserved with total provisions of $24.7 million. Non-performing loans totalled $27.0 million as at 31 December 2005, up from $20.5 million a year ago, reflecting loan growth. They represent 0.9% of the total loan portfolio, compared to 0.8% a year ago. Provisions in respect of credit losses charged to income were $3.2 million, compared to $2.9 million last year.

Non-interest income grew by 10.0% to $172.1 million, reflecting growth across all revenue lines, notably from asset management (+20.8%), foreign exchange (+17.3%), and investment & pension fund administration (+15.4%).

Other revenues during the year totalled $0.9 million, down from $6.6 million the previous year reflecting a $5.8 million gain on sale of an affiliate in 2004.

Changes in Net Interest Income

For the year ended 31 December (In $ thousands)

	2005			2004		
	Average balance	Interest	Rate	Average balance	Interest	Rate
Assets						
Cash and deposits with banks	2,660,107	69,346	2.6%	2,654,554	46,275	1.7%
Investments	3,307,160	129,092	3.9%	2,952,327	89,553	3.0%
Loans	2,855,086	180,743	6.3%	2,300,024	130,743	5.7%
Earning assets	8,822,353	379,181	4.3%	7,906,904	266,571	3.4%
Other assets	333,286	–	–	275,191	–	–
Total assets	9,155,639	379,181	4.1%	8,182,095	266,571	3.3%
Liabilities						
Deposits	7,345,378	188,493	2.6%	6,444,827	115,249	1.8%
Subordinated capital and senior debt	223,335	8,514	3.8%	132,602	3,247	2.4%
Interest bearing liabilities	7,568,713	197,007	2.6%	6,577,429	118,496	1.8%
Non interest bearing current accounts	963,599	–	–	1,070,187	–	–
Other liabilities	157,380	–	–	129,248	–	–
Total liabilities	8,689,692	197,007	2.3%	7,776,863	118,496	1.5%
Shareholders' equity	465,947			405,232		
Total liabilities and shareholders' equity	9,155,639			8,182,095		
Spread			1.7%			1.6%
Net interest margin			2.1%			1.9%

Note: Underlying assets and liabilities are comprised of various currencies.

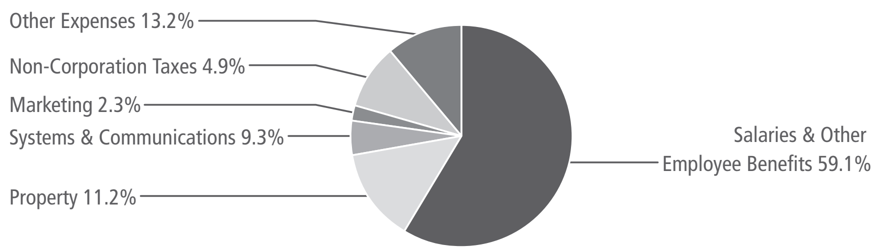
Financial Overview

Expenses

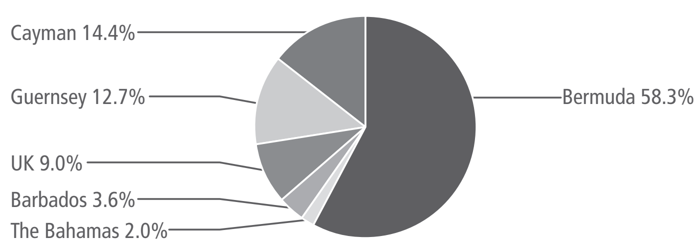
The Group remains committed to the prudent management of its expense base and continually seeks opportunities to improve efficiency. The efficiency ratio was 66.4% in 2005, down from 69.1% in 2004, reflecting the growth in the Group's operating revenue, up 14.1%, was higher than the percentage increase for operating expenses, which were up 9.8% year on year.

The operating expense increase primarily reflected the expanding size of the Group with salaries and employee benefits up 13.2% to $144.3 million, and accounting for 59.1% of total Group operating expenses, compared with 57.3% last year. Increases of 16.5% and 17.0% respectively were seen in systems and communication and marketing costs, reflecting continued spending on information systems and marketing as we build and improve our operations.

At 31 December 2005 there were 789 employees in Bermuda, up from 786 a year ago. Overseas, the total headcount increased by 42 to 808 primarily due to continued growth in Cayman.



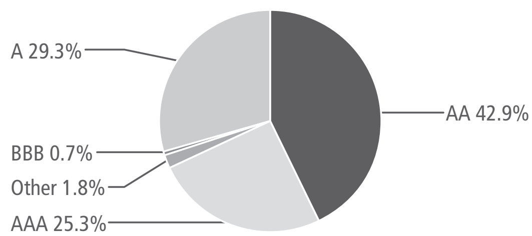
Distribution Of 2005 Total Expenses



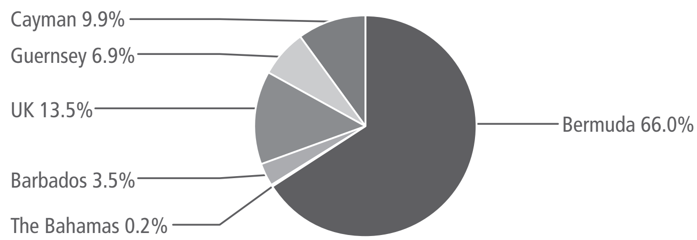
Distribution Of 2005 Expenses By Location

Balance Sheet

Total assets increased by 6.6% to $9.2 billion, up from $8.6 billion a year ago. This increase reflects the rise in the customer deposit base, up year on year by $0.5 billion, or 7.3%, to $7.9 billion. The increase in the customer deposit base was primarily employed in term deposits with banks, and in funding our loan portfolios, which were both up year on year by 20.7% and 16.6% respectively to $2.7 billion and $3.1 billion. The Balance Sheet remains highly liquid with a loans to customer deposits ratio of 38.8% and loans to total assets ratio of 33.5%.

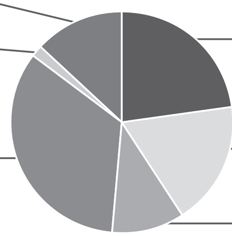


Investment Portfolio By Long Term Debt Rating



Lending By Location

Financial Overview



Group Loans By Type

Taxes

For the period under review the corporation tax of the Group was an expense of $1.6 million compared to a credit of $1.7 million for the same period a year ago. Corporation tax of $0.9 million in Guernsey, $0.6 million in Barbados and $0.1 million in the UK was incurred for the year. $11.9 million in non-profits taxes was also paid across the Group, up from $10.8 million in the previous year, primarily reflecting an increase in employer related payroll tax paid in Bermuda.

Capital and Liquidity

The Group continues to maintain a strong capital base that ensures stability and allows it to take advantage of opportunities for growth. At 31 December 2005 the risk weighted total capital ratio was 13.1%, compared to the 10.0% minimum requirement of the Bermuda Monetary Authority, and up from 10.7% a year ago. Of the total, the Tier 1 ratio was 8.6%, compared to a 5% minimum requirement and 7.3% at year-end 2004. Shareholders' equity increased by $67.2 million, or 15.7%, over a year ago reflecting the increase in retained earnings less share buy-backs.

Weighted risk assets rose year on year by 5.8% to $4.7 billion, primarily due to growth in loans and deposits with banks, offset by reductions in investments and letters of credit. The loan to the Stock Option Trust of $25.5 million is in respect of potential obligations under the Group's Stock Option Plan and is deducted from shareholders' equity as treasury stock. The loan remained at the same level as a year ago, reflecting repayments from cash received on the exercise of stock options by directors and employees, offset by the purchase by the Trust of 285,854 shares at a total cost of $12.6 million during the year.

In June 2005 the Group successfully issued US$150 million of subordinated lower tier II capital notes by way of a private placement with US institutional investors. The notes were issued in two tranches, namely US$90 million in Series A notes due 2015, and US$60 million in Series B notes due 2020. The Series A notes were priced at a coupon of 1.00% over the five year US Treasury yield and Series B notes at 1.10% over the ten year US Treasury yield. This brings the Group's total subordinated capital issued to $283.6 million and provides capital financing to support business growth.

During the year under review, the Group issued 242,738 shares under the Dividend Re-investment Programme, which represents a cash savings of $10.6 million, or 26.4% of the total dividend declared. As a result of the one-for-ten stock dividend in August 2005 2,436,730 new shares were also issued. Under the Share Buy-Back Plan, the Bank repurchased and cancelled 32,890 shares, at a cost of $1.4 million.

Capital Composition

(In $ thousands)

For the year ended 31 December	2005	2004
Tier 1 capital	**402,766**	321,987
Tier 2 capital	**222,012**	156,496
Deductions*	**(13,351)**	(4,272)
Total capital	**611,427**	474,211

Weighted Risk Assets
(In $ thousands)

Cash and inter-bank placements	**569,030**	471,518
Investments	**874,306**	1,064,824
Loans	**2,407,471**	2,005,775
Other assets	**218,971**	189,583
Off-balance sheet items	**611,571**	691,594
Total weighted risk assets	**4,681,349**	4,423,294

Capital Ratios (%)

Tier 1	**8.6%**	7.3%
Tier 2	**4.7%**	3.5%
Deductions*	**(0.2%)**	(0.1%)
Total	**13.1%**	10.7%

*Deductions from capital comprise investments in affiliates

Financial Overview

Selected Quarterly Results of Operations

(Unaudited, in $ thousands except per share data and ratios)

	2005			
Quarter ended	**31 December**	**30 September**	**30 June**	**31 March**
Net interest income after provision for credit losses	**47,918**	**47,602**	**45,760**	**40,894**
Total fees and other income	**42,638**	**43,919**	**44,564**	**41,834**
Total revenue	**90,556**	**91,521**	**90,324**	**82,728**
Total non-interest expense	**66,218**	**60,893**	**60,274**	**58,393**
Net income for the quarter	**24,338**	**30,628**	**30,050**	**24,335**
Earnings per share ($)*				
Basic	**0.97**	**1.21**	**1.19**	**0.97**
Diluted	**0.93**	**1.18**	**1.17**	**0.95**
Return on shareholders' equity (%)	**19.7**	**25.7**	**27.3**	**22.7**

	2004			
Quarter ended	31 December	30 September	30 June	31 March
Net interest income after provision for credit losses	38,340	43,011	35,151	31,573
Total fees and other income	40,105	39,851	41,067	36,317
Gain on sale of affiliate	–	–	–	5,750
Total revenue	78,445	82,862	76,218	73,640
Total non-interest expense	56,858	60,012	55,879	47,950
Net income for the quarter	21,587	22,850	20,339	25,690
Earnings per share ($)*				
Basic	0.87	0.91	0.81	1.03
Diluted	0.84	0.89	0.79	0.99
Return on shareholders' equity (%)	19.3	22.0	20.1	25.5

*Comparative per share data has been restated to reflect the 1 for 10 stock dividends in August 2005 and 2004.

Financial Summary

(In thousands of Bermuda dollars, except per share data)

	31 December 2005	31 December 2004	Year ended 31 December 2003	31 December 2002	30 June 2002
At year end					
Cash and deposits with banks	**2,849,920**	2,396,724	2,912,383	1,989,159	2,027,225
Investments	**2,916,399**	3,266,400	2,638,253	2,073,112	1,831,142
Loans, net of allowance for credit losses	**3,085,594**	2,645,331	1,954,716	1,767,088	1,696,775
Premises, equipment and computer software	**141,708**	126,031	99,979	96,419	98,536
Total assets	**9,197,566**	8,630,383	7,733,806	6,007,874	5,738,044
Total deposits	**8,240,109**	7,907,450	7,122,577	5,516,216	5,216,366
Subordinated capital and senior debt	**278,679**	142,333	122,871	75,000	75,000
Shareholders' equity	**495,226**	428,030	382,095	338,799	335,167
For the year				(unaudited)	
Net interest income after provision for credit losses	**182,174**	148,075	115,066	97,503	97,237
Fee and other income	**172,955**	163,090	118,985	114,832	109,322
Gain on sale of subsidiaries	**–**	–	–	17,013	17,013
Salaries and other employee benefits	**144,331**	127,459	100,104	88,612	88,623
Other non-interest expenses	**101,447**	93,240	63,109	56,993	53,533
Net income from continuing operations	**109,351**	90,466	70,838	83,743	81,416
Net income	**109,351**	90,466	70,838	83,927	82,289
Dividends paid	**38,504**	32,217	26,809	25,432	24,081
Financial ratios					
Return on assets*	**1.2%**	1.1%	1.0%	1.2%	1.2%
Return on shareholders' equity*	**23.6%**	21.2%	17.9%	20.5%	21.2%
Dividend payout ratio	**35.2%**	35.6%	37.8%	30.3%	29.3%
Total capital funds to total assets ratio	**8.4%**	6.6%	6.5%	6.9%	7.0%
Risk weighted capital ratio	**13.1%**	10.7%	13.0%	13.1%	13.8%
Efficiency ratio	**66.4%**	69.1%	67.7%	66.4%	61.9%
Per share ($) #**					
Net income from continuing operations (diluted)	**4.23**	3.51	2.79	2.96	3.09
Net income (diluted)	**4.23**	3.51	2.79	2.96	3.12
Dividends declared	**1.67**	1.55	1.43	1.37	1.31
Net book value	**19.48**	17.13	15.30	13.68	13.08
Number of employees					
Bermuda	**789**	786	734	724	749
Overseas	**808**	766	647	476	480
Total	**1,597**	1,552	1,381	1,200	1,229
Shareholder data					
Number of shareholders	**3,878**	3,778	3,581	3,322	3,364
Number of shares (in thousands)**	**25,429**	22,745	20,643	18,603	19,247

* Excludes discontinued operations and gain on sale of subsidiaries.
** Excludes shares held by the Bank's Stock Option Trust.
Comparative per share data, with the exception of dividends has been restated to reflect the 1 for 10 stock dividends in August 2005, 2004 and 2003. The number of shares in 2005 increased primarily due to the issue of the stock dividend.
\# Inclusive of gain on sale of subsidiaries.
Data for 2005, 2004 and 2003 is shown under US GAAP and for 2002 under Canadian GAAP.

Management's Financial Reporting Responsibility

The Management of The Bank of N.T. Butterfield & Son Limited is responsible for the preparation of the consolidated financial statements contained in this Report, which covers all of the interests of the Bank. Management has fully disclosed its income, assets, liabilities and off balance sheet commitments. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and, where appropriate, are based on the best estimates and judgement of management.

Management has established and maintains a system of financial reporting and internal controls to provide reasonable assurance that transactions are properly authorised and recorded, assets are protected against unauthorised use or disposition and liabilities are recognised. These procedures include the careful selection and training of qualified staff, the establishment of organisational structures providing an appropriate and well-defined division of responsibilities, and the communication of policies and standards of business conduct throughout the Bank.

The system of internal controls is further supported by a professional staff of internal auditors who conduct periodic inspections of all aspects of the Bank's operations. In addition, the Bank's Head of Group Internal Audit has full and free access to the Audit & Compliance Committee of the Board of Directors.

The Audit & Compliance Committee, composed entirely of directors who are not employees of the Bank, reviews the financial statements before such statements are approved by the Board of Directors and submitted to the Bank's shareholders. The Committee meets and consults regularly with Management, the internal auditors and our external independent auditors to review the scope and results of their work.

Under the provisions of the Bermuda Monetary Authority Act 1969, the Bermuda Monetary Authority is charged with the supervision of the Bank. Such supervision is in line with international practices and combines a comprehensive system of statistical returns, providing a detailed breakdown of the balance sheet and statement of income accounts of the Bank, and regular meetings with the senior management of the Bank. Such regular reviews are intended to satisfy the Authority that the safety and interests of the depositors, creditors and shareholders of the Bank are being duly observed and that the Bank is in a sound financial condition.

The accounting firm of PricewaterhouseCoopers, the shareholders' independent auditors, has examined the consolidated financial statements of the Bank in accordance with auditing standards generally accepted in the United States of America and have expressed their opinion in their report to the shareholders. The auditors have unrestricted access to, and meet periodically with, the Audit & Compliance Committee to review their findings regarding internal controls over the financial reporting process, auditing matters and financial reporting issues. Management has made available to PricewaterhouseCoopers all of the Bank's financial records and related data as well as the minutes of shareholders' and directors' meetings.

Alan R. Thompson
President & Chief Executive Officer
2 March 2006

Richard J. Ferrett
Executive Vice President & Chief Financial Officer
2 March 2006

Independent Auditors' Report to the Shareholders

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2 March 2006

Independent Auditors' Report

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

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, changes in shareholders' equity and comprehensive income, and of cash flows present fairly, in all material respects, the financial position of The Bank of N.T. Butterfield & Son Limited at 31 December 2005 and 2004 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements 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 financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statements presentation. We believe that our audits provide a reasonable basis for our opinion.

PricewaterhouseCoopers

Chartered Accountants

Financials

Consolidated Balance Sheet

As at 31 December (in $ thousands)

	2005	2004
Assets		
Cash and demand deposits with banks	**154,698**	164,431
Term deposits with banks	**2,695,222**	2,232,293
Total cash and deposits with banks	**2,849,920**	2,396,724
Investments		
Held to maturity	**2,233,577**	2,592,824
Available for sale	**546,302**	29,681
Trading	**136,520**	643,895
Total investments	**2,916,399**	3,266,400
Loans, net of allowance for credit losses	**3,085,594**	2,645,331
Premises, equipment and computer software	**141,708**	126,031
Accrued interest	**44,648**	30,843
Goodwill	**22,840**	24,638
Other intangible assets	**69,622**	81,405
Other assets	**66,835**	59,011
Total assets	**9,197,566**	8,630,383
Liabilities		
Deposits		
Non-interest bearing	**858,358**	999,826
Interest bearing		
Customers	**7,090,608**	6,405,029
Banks	**291,143**	502,595
Total deposits	**8,240,109**	7,907,450
Accrued interest	**19,093**	9,120
Dividend payable	**11,049**	9,235
Other liabilities	**153,410**	134,215
Total other liabilities	**183,552**	152,570
Subordinated capital and senior debt	**278,679**	142,333
Total liabilities	**8,702,340**	8,202,353
Shareholders' equity		
Share capital ($1.00 par: Authorised shares 70,000,000)	**26,948**	24,301
Additional paid in capital	**341,647**	229,495
Retained earnings	**152,501**	188,674
Less: treasury stock	**(25,548)**	(25,471)
Accumulated other comprehensive income	**(322)**	11,031
Total shareholders' equity	**495,226**	428,030
Total liabilities and shareholders' equity	**9,197,566**	8,630,383

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

James A.C. King, JP
Chairman of the Board

Robert J. Stewart, JP
Vice Chairman

Alan R. Thompson
President & Chief Executive Officer

Consolidated Statement of Income

For the year ended 31 December (In $ thousands, except per share data)

	2005	2004
Non-interest income		
Trust and investment services	**29,309**	28,690
Asset management	**34,687**	28,706
Investment and pension fund administration	**39,617**	34,339
Banking services	**36,404**	36,396
Foreign exchange revenue	**29,894**	25,488
Other non-interest income	**2,188**	2,868
Total non-interest income	**172,099**	156,487
Interest income		
Deposits with banks	**69,346**	46,275
Loans	**183,915**	133,637
Investments	**129,092**	89,553
Total interest income	**382,353**	269,465
Interest expense		
Deposits	**188,493**	115,249
Subordinated capital and senior debt	**8,514**	3,247
Total interest expense	**197,007**	118,496
Net interest income before provision for credit losses	**185,346**	150,969
Provision for credit losses	**(3,172)**	(2,894)
Net interest income after provision for credit losses	**182,174**	148,075
Other loss	**(129)**	(156)
Gain on sale of affiliate	**–**	5,750
Realised / unrealised gains on trading securities	**895**	647
Realised gains on available for sale securities	**90**	362
Total revenue	**355,129**	311,165
Non-interest expense		
Salaries and other employee benefits	**144,331**	127,459
Property	**27,301**	26,970
Systems and communications	**22,813**	19,589
Marketing	**5,658**	4,836
Other expenses	**44,047**	43,567
Total non-interest expense	**244,150**	222,421
Net income before income taxes	**110,979**	88,744
Income taxes	**(1,628)**	1,722
Net income	**109,351**	90,466
Earnings per share		
Basic	**4.34**	3.62
Diluted	**4.23**	3.51

The accompanying notes are an integral part of these consolidated financial statements.
Earnings per share comparative figures have been restated for the 1 for 10 stock dividend in August 2005.

Financials

Consolidated Statement of Changes in Shareholders' Equity and Comprehensive Income

For the year ended 31 December (In $ thousands)

	2005	2004
Share capital		
Authorised: 70,000,000 shares (2004: 70,000,000) of par value $1 each		
Issued		
Issued and outstanding at beginning of year	**24,301**	22,335
(January 2005: 24,301,337 shares; January 2004: 22,335,533 shares)		
Dividend reinvestment	**243**	207
(December 2005: 242,738 shares; December 2004: 207,109 shares)		
Stock dividend	**2,437**	2,218
(December 2005: 2,436,730 shares; December 2004: 2,217,927 shares)		
Shares repurchased and cancelled	**(33)**	(459)
(December 2005: 32,890 shares; December 2004: 459,232 shares)		
Issued and outstanding at end of year	**26,948**	24,301
(December 2005: 26,947,915; December 2004: 24,301,337 shares)		
Additional paid in capital		
Balance at beginning of year	**229,495**	149,454
Dividend reinvestment	**10,395**	8,659
Stock dividend	**102,769**	89,941
Issued under directors' and executive officers' and employees’ stock option plans	**321**	413
Shares repurchased and cancelled	**(1,333)**	(18,972)
Balance at end of year	**341,647**	229,495
Retained earnings		
Balance at beginning of year	**88,674**	124,002
Net income for year	**109,351**	90,466
	198,025	214,468
Cash dividends declared	**(40,318)**	(33,635)
Stock dividend	**(105,206)**	(92,159)
Balance at end of year	**52,501**	88,674
Appropriated retained earnings – general reserve	**100,000**	100,000
Accumulated other comprehensive income		
Balance at beginning of year	**11,031**	17,362
Net change in unrealised gains (losses) on translation of net investment in foreign operations	**(7,752)**	4,455
Net change in unrealised gains (losses) on available for sale securities	**(328)**	201
Net change in unrealised losses on cash flow hedges	**(2,869)**	(10,987)
Net change in minimum pension liability	**(404)**	–
Balance at end of year	**(322)**	11,031
Treasury stock		
Balance at beginning of year (January 2005: 1,556,476 shares; January 2004: 1,692,698 shares)	**(25,471)**	(31,058)
Net issuances (purchases)	**(77)**	5,587
Balance at end of year	**(25,548)**	(25,471)
(December 2005: 1,519,203 shares; December 2004: 1,556,476 shares)		
Total shareholders' equity	**495,226**	428,030
Comprehensive income		
Net income	**109,351**	90,466
Other comprehensive loss	**(11,353)**	(6,331)
Total comprehensive income	**97,998**	84,135

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

Consolidated Statement of Cash Flows

For the year ended 31 December (In $ thousands)

	2005	2004
Cash flows from operating activities		
Net income for the year	109,351	90,466
Adjustments to reconcile net income to cash provided by operating activities		
Depreciation and amortisation	20,822	18,390
Write down of equipment and computer software	1,100	–
Change in carrying value of investment in affiliate	833	1,543
Gain on sale of affiliate	–	(5,750)
Realised gain on sale of available for sale securities	(90)	–
Provision for credit losses	3,172	2,894
Increase in accrued interest receivable	(15,237)	(8,015)
Increase in other assets	(10,359)	(6,549)
Increase in accrued interest payable	10,743	1,488
Increase in other liabilities	30,280	23,473
	150,615	117,940
Net change in trading account securities	487,611	13,561
Cash provided by operating activities	638,226	131,501
Cash flows from investing activities		
Term deposits with banks	(555,669)	647,946
Additions to premises, equipment and computer software	(35,569)	(34,732)
Net change in loans	(504,151)	(432,538)
Held to maturity securities: proceeds from maturities	1,168,313	623,860
Held to maturity securities: purchases	(883,195)	(765,797)
Available for sale securities: proceeds from sale and maturities	731,186	(2,008)
Available for sale securities: purchases	(1,263,259)	–
Net proceeds on sale of affiliate	–	8,250
Purchase of subsidiaries	–	(116,626)
Cash used in investing activities	(1,342,344)	(71,645)
Cash flows from financing activities		
Increase in demand and term deposit liabilities	583,108	19,718
Issuance of subordinated capital and senior debt	150,000	10,000
Repayment of senior debt	(9,666)	–
Proceeds from dividend re-investment plan	10,638	8,866
Shares repurchased and cancelled	(1,366)	(19,431)
Treasury stock	(77)	5,587
Cash dividends paid	(38,504)	(32,217)
Cash provided by (used in) financing activities	694,133	(7,477)
Effect of exchange rates on cash and demand deposits with banks	252	350
Net increase (decrease) in cash and demand deposits with banks	(9,733)	52,729
Cash and demand deposits with banks: beginning of year	164,431	111,702
Cash and demand deposits with banks: end of year	154,698	164,431
Supplemental disclosure of cash flow information		
Amount of interest paid in the year	187,429	117,008
Amount of income tax paid in the year	322	1,649

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

Notes to Consolidated Financial Statements

For the year ended 31 December 2005 (All amounts are expressed in thousands of Bermuda dollars unless otherwise stated)

NOTE 1: Significant Accounting Policies

(a) Basis of Presentation

The accounting and financial reporting policies of The Bank of N.T. Butterfield & Son Limited (the Bank) and its subsidiaries conform to Generally Accepted Accounting Principles in the United States of America (GAAP). The preparation of 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 financial statements and the reported amounts of revenues and expenses during the period. Such estimates are subject to change in the future as additional information becomes available or previously existing circumstances are modified.

(b) Basis of Consolidation

The Bank consolidates subsidiaries where it holds, directly or indirectly, more than 50% of the voting rights or where it exercises control. 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 variable interest entities (VIEs), are accounted for under the equity method, and the pro rata share of their income (loss) is included in other income. The Bank consolidates entities deemed to be VIEs when the Bank is determined to be the primary beneficiary under the Financial Accounting Standards Board (FASB) interpretation No. 46 (Revised 2003) Consolidation of Variable Interest Entities (FIN 46R).

(c) Foreign Currency Translation

Assets, liabilities, revenues and expenses denominated in US dollars are translated to Bermuda dollars at par. Assets and liabilities 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 Income.

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 period. 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. Such gains and losses are recorded in the Consolidated Statement of Income 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 since the Bank is not the beneficiary of these assets.

(e) Investments

Investments include debt and equity securities. Debt securities include bonds, notes, redeemable preferred stock, as well as certain loan or asset backed and structured securities subject to prepayment risk. Equity securities include common and non-redeemable preferred stocks. Debt securities classified as "held to maturity" represent securities that the Bank has both the ability and the intent to hold until maturity and are carried at amortised cost adjusted to recognise other than temporary impairment, except for money market mutual funds which are carried at market value, which approximates cost plus accrued and reinvested interest since acquisition. Debt securities and marketable equity securities classified as "available for sale" are carried at fair value, adjusted to recognise other than temporary impairment with unrealised gains and losses reported in Other Comprehensive Income. Debt and equity securities classified as "trading" securities are carried at fair value, with the unrealised gains and losses included in the Consolidated Statement of Income as gains and losses on trading.

Fair value is determined based on the quoted market price when available or, if quoted market prices are not available, discounted expected cash flows using market rates commensurate with the credit quality and maturity of the investment. In respect of held to maturity or available for sale securities, declines in fair value that are determined to be other than temporary are charged to earnings. 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. Realised gains and losses on sales of investments are included in earnings on a specific identified cost basis.

Venture capital investments are recorded at fair value with adjustments to fair value being recognised in investment income. In assessing fair value, management reviews meaningful third party transactions in the private market and the results of applying acceptable valuation methodologies to current and projected cash flows. In the absence of persuasive evidence to the contrary, management generally considers cost to be the best indicator of fair value. Due to the dynamic nature of assumptions used in establishing fair values, the values reflected in the consolidated financial statements may differ materially from the values that would be determined by negotiations held between parties in a sales transaction.

(f) Loans

Loans are reported at 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 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. Non-accrual loans are those on which the accrual of interest is discontinued. Loans 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 fully secured and any collection efforts are reasonably expected to result in repayment of all amounts due under the contractual terms of the loan.

Interest accrued but not collected at the date a loan is placed on non-accrual status is reversed against interest income. In addition, the amortisation of net deferred loan fees is suspended. Interest income on non-accrual loans is recognised only to the extent it is received in cash. However, where there is doubt regarding the ultimate collectivity of the loan principal, all cash thereafter received is applied to reduce the carrying value of the loan. Loans are restored to accrual status only when interest and principal payments are brought current and future payments are reasonably assured.

Credit card loans that are contractually 180 days past due and consumer loans with an outstanding balance under $100,000 that are contractually 180 days past due are automatically written off.

The Bank accounts for and discloses non-accrual commercial loans as impaired loans, and recognises their interest income as previously discussed for non-accrual loans. Accordingly, interest income on these loans is recognised after the entire recorded investment is recovered, and interest is actually received. In addition, the amortisation of net deferred loan fees is suspended.

(g) Allowance for Credit Losses

The Bank maintains an allowance for credit losses, which in management's opinion is adequate to absorb all incurred credit related losses in its portfolio relating to on and off balance sheet financial instruments. The allowance for credit losses consists of specific allowances and a general allowance, each of which is reviewed on a regular basis. The allowance for credit losses is included as a reduction of the related asset category.

(h) Specific Allowances

Specific allowances are determined on an item by item basis and reflect the associated estimated credit loss. The specific allowances for credit loss is computed as the difference between the recorded investment in the loan and 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 a valuation allowance with a corresponding charge to bad debt expense.

(i) General Allowances

The allowance for credit losses attributed to the remaining portfolio is established through a process that estimates the probable loss inherent in the portfolio based upon various analyses. 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 mortgage, installment, 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 in the portfolio, based upon various analyses. Management considers overall portfolio indicators including historical credit losses; delinquent (defined as loans with payments contractually over 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 if events or circumstances such as adverse changes in the business climate 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 reevaluated annually and an impairment test is carried out if certain indicators of impairment exist.

(k) Premises, Equipment and Computer Software

Land, building, 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 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 7 years. If deemed significant the Bank will capitalise interest cost in accordance with FAS No. 34 Capitalisation of Interest Cost (FAS 34).

(l) Derivatives

In accordance with FAS No. 133 Accounting for Derivative Instruments and Hedging Activities (FAS 133), all derivatives are recognised on the Consolidated Balance Sheet at their fair value. FAS 133, as amended by FAS No. 138 Accounting for Certain Derivative Instruments and Certain Hedging Activities (FAS 138) and FAS No. 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities (FAS 149), establishes accounting and reporting standards for financial derivatives, including certain financial derivatives embedded in other contracts and hedging activities. On the date that the Bank enters into a derivative contract, it designates the derivative as either: 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).

Changes in the fair value of a derivative that is highly effective, and 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 period earnings. Changes in the fair value of a derivative that is highly effective and 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 period earnings.

Changes in the fair value of a derivative that is highly effective as and that is designated and qualifies as a foreign currency hedge is recorded in either current period earnings or other comprehensive income, depending on whether the hedging relationship satisfies the criteria for a fair value or cash flow hedge. 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 period 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 immediately reflected in other income.

(m) Employee Future Benefits

The Bank maintains trusteed pension plans for substantially all employees including non-contributory defined benefit plans and a number of 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 substantially all retired Bermuda based employees.

The Bank's defined benefit pension plans are accounted for in accordance with FAS No. 87 Employers' Accounting for Pensions (FAS 87) and FAS No. 88 Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits (FAS 88). Its post-retirement medical and life insurance plans are accounted for in accordance with FAS No. 106 Employers' Accounting for Postretirement Benefits Other Than Pensions (FAS 106).

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 plan, the expected investment return on the market value of plan assets and (d) amortisation of certain items over the expected average remaining service life of employees in the case of the 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 experience 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 the revised accounting standard.

For each of the defined benefit pension plans, the cumulative excess (deficit) of funding contributions over expenses is reported in other assets (other liabilities). For the post-retirement medical benefits plan, the liability recognised for accounting purposes is reported in other liabilities.

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

(n) Stock Based Compensation

The Bank has a stock option plan for all eligible employees. The Bank follows the intrinsic value method of accounting for stock options. Since the exercise price is set at an amount equal to the closing price on the day of the grant of stock options, no compensation cost is recognised on the day of the grant.

(o) Revenue Recognition

Trust and investment services fees include fees for private and institutional trust, executorship, and custody services. These fees are recognised as revenue 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 other contingencies associated with the fee.

Asset management fees include fees for investment management, investment advice and brokerage services. Investment management fees are recognised over the period in which the related service is provided, on a net asset value basis. Investment advice and brokerage services fees are recognised in the period in which the related service is provided.

Investment and pension fund administration fees include fees for pension fund administration, institutional fund administration, registration and transfer agent and corporate services. Pension and institutional fund administration fees are recognised as revenue 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 other contingencies associated with the fee. All other fees are recognised as revenue over the period of the relationship.

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. In accordance with FAS No. 91 Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (FAS 91), 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 on all securities, including amortisation of premiums and discounts on debt securities held for investment, are included in investment income in the Consolidated Statement of Income.

(p) Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale. The accounting for an asset or liability may differ based on the type of instrument and / or its use in a trading or investing strategy. Generally, the measurement framework recorded in financial statements is based on one of the following:

- At fair value on the Consolidated Balance Sheet, with changes in fair value recorded each period in the Consolidated Statement of Income.
- At fair value on the Consolidated Balance Sheet, with changes in fair value recorded each period as a separate component of shareholders' equity and as part of other comprehensive income.
- At cost (less other than temporary impairments), with changes in fair value not recorded in the financial statements but disclosed in the notes.
- At the lower of cost or fair value.

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act and is best evidenced by a quoted market price, if one exists. Some of the Bank's financial instruments lack an available trading market. Therefore, these instruments have been valued using present value or other valuation techniques and may not necessarily be indicative of the amounts realisable in an immediate settlement of the instruments. In addition, the calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values.

The book value of financial assets and financial liabilities held for purposes other than trading may exceed their fair value due primarily to changes in interest rates. In such instances, the Bank does not reduce the book value of these financial assets and financial liabilities to their fair values as it is the Bank's intention to hold them until maturity. The fair values disclosed exclude premises and equipment and certain other assets and liabilities as these are not financial instruments.

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

i) **Cash and deposits with banks:** The fair value of cash and deposits with banks, being short term in nature, is deemed to equate to the carrying value.

ii) **Investments:** The fair values of investments are based upon quoted market prices where available.

iii) **Loans:** The majority of loans are variable rate and re-price in response to changes in market rates and hence the fair value has been estimated as the carrying value. For fixed-rate loans, the fair value has been estimated by performing a discounted cash flow calculation using market rates for similar loans made at the balance sheet date.

iv) **Accrued interest:** The carrying values of accrued interest receivable and payable are assumed to approximate their fair values given their short-term nature.

v) **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 fair value of deposits with no stated maturity date is deemed to equate to the carrying value.

vi) **Subordinated capital and senior debt:** The fair value of the subordinated capital and senior debt is based on current market pricing.

vii) **Derivatives:** Fair value of exchange traded derivatives is based on quoted market prices. Fair value of over the counter derivatives is calculated as the net present value of contractual cash flows using prevailing market rates. The aggregate of the estimated fair value of amounts presented does not represent management's estimate of the underlying value of the Bank.

(q) 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:

i) 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.

ii) 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.

iii) Documentary and commercial letters of credit, primarily related to the import of goods into Bermuda 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 11 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 fully collateralised, the contractual amounts do not necessarily represent future cash requirements. The Bank does not carry any liability for these obligations.

(r) Income Taxes

The Bank uses the asset and liability method whereby income taxes reflect the expected future tax consequences of temporary differences between the 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. Income taxes on the Consolidated Statement of Income include the current and deferred portions of the income taxes. Income taxes applicable to items charged or credited directly to shareholders' equity are included in such items.

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.

(s) Consolidated Statement of Cash Flows

For the purposes of the Consolidated Statement of Cash Flows, cash and demand deposits with banks include cash and demand deposits; vault cash and cash in transit where the Bank holds the related assets.

(t) Earnings Per Share

Earnings per share has been calculated using the weighted average number of shares outstanding during the year and adjusted for the stock dividends declared during the year ended 31 December 2004 and 2005 (see also Notes 18 and 22). The dilutive effect of stock options was calculated using the treasury stock method, whereby the proceeds received from the exercise of stock options are assumed to be used to repurchase outstanding shares, using the quarterly average market price of the Bank's shares for the period.

(u) Consolidation of Variable Interest Entities

FIN 46R requires a VIE holder to consolidate the VIE if that party will absorb a majority of the expected losses of the VIE, receive a majority of residual returns of the VIE, or both. This party is considered the primary beneficiary of the entity. The determination of whether an entity meets the criteria to be considered the primary beneficiary of a VIE requires an evaluation of all transactions (such as investments, loans and fee arrangements) with the entity.

(v) Impairment or Disposal of Long-Lived Assets

An impairment loss is recognised when the carrying amount of a long-lived asset to be held and used 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.

NOTE 2: Significant Acquisitions

There were no significant acquisitions in 2005.

On 2 February 2004, the Bank acquired all the outstanding shares of Deerfield Fund Services Limited, a fund administration services provider based in The Bahamas for $4.3 million paid in cash. The company was renamed Butterfield Fund Services (Bahamas) Limited in 2004.

On 5 February 2004, the Bank announced that Bank of Butterfield (UK) Limited had made a cash offer for the entire and to be issued share capital of Leopold Joseph Holdings plc. (Leopold Joseph) subject to Leopold Joseph shareholder and appropriate regulatory approvals. The cash offer was £9.50 in cash per Leopold Joseph share, valuing the existing issued share capital of Leopold Joseph at approximately £55.1 million ($103.6 million). The offer price, which had the unanimous recommendation of the directors of Leopold Joseph, represented a premium of 11.1% to the closing price of £8.55 per share on 4 February 2004, being the last business day prior to the announcement of the offer. On 2 April 2004 the Bank announced that it had acquired all the outstanding common shares of Leopold Joseph and that all the conditions of the Bank's offer had been satisfied unconditionally. The principal activities of Leopold Joseph were private banking, treasury, investment management, offshore company administration and trust services to companies and high net worth individuals and families. The company was renamed Butterfield Bank (UK) Limited in 2004.

On 8 October 2004, the Bank acquired all outstanding shares of Grosvenor Trust Company Limited (Grosvenor) a specialist trust business based in Bermuda for $8.7 million. The total consideration in respect of this acquisition was paid in cash.

The following table summarises the total consideration in respect of significant acquisitions:

	2005	2004			
		Deerfield	Leopold Joseph	Grosvenor	Total
Fair value of assets acquired					
Cash and deposits with banks	–	205	78,957	396	79,558
Investments	–	–	497,258	–	497,258
Loans	–	–	260,971	–	260,971
Premises, equipment and computer software	–	173	4,126	41	4,340
Intangible assets – customer relationships	–	2,700	32,439	8,337	43,476
Intangible assets – goodwill	–	1,031	13,695	–	14,726
Other assets	–	290	13,466	988	14,744
Total assets	–	4,399	900,912	9,762	915,073

	2005	2004			
		Deerfield	Leopold Joseph	Grosvenor	Total
Fair value of liabilities assumed					
Deposits	–	–	765,155	–	765,155
Other liabilities	–	149	23,229	1,022	24,400
Subordinated capital	–	–	8,892	–	8,892
Total liabilities	–	149	797,276	1,022	798,447
Fair value of identifiable net assets acquired	–	4,250	103,636	8,740	116,626
Total purchase consideration	–	4,250	103,636	8,740	116,626

NOTE 3: Cash and Deposits with Banks

	2005			2004		
31 December	**Bermuda**	**Non-Bermuda**	**Total**	Bermuda	Non-Bermuda	Total
Unrestricted						
Non-interest earning						
Cash and demand deposits	**22,962**	**16,200**	**39,162**	118,975	25,651	144,626
Interest earning						
Deposits maturing within three months and on demand	**307,898**	**1,628,157**	**1,936,055**	124,688	160,042	284,730
Deposits maturing between three to six months	**–**	**810,453**	**810,453**	10,000	1,898,352	1,908,352
Deposits maturing between six to twelve months	**–**	**58,235**	**58,235**	–	39,211	39,211
Sub-total – Interest earning	**307,898**	**2,496,845**	**2,804,743**	134,688	2,097,605	2,232,293
Total unrestricted cash and deposits	**330,860**	**2,513,045**	**2,843,905**	253,663	2,123,256	2,376,919
Affected by drawing restrictions related to minimum reserve and derivative margin requirements						
Interest earning						
Deposits maturing within three months	**1,586**	**4,429**	**6,015**	1,535	18,270	19,805
Subtotal – Interest earning	**1,586**	**4,429**	**6,015**	1,535	18,270	19,805
Total restricted deposits	**1,586**	**4,429**	**6,015**	1,535	18,270	19,805
Total cash and deposits with banks	**332,446**	**2,517,474**	**2,849,920**	255,198	2,141,526	2,396,724

NOTE 4: Investments

Trading

Trading assets include debt and equity securities held for trading purposes that the Bank owns ("long" positions). Trading positions are carried at fair value on the Consolidated Balance Sheet.

31 December	**2005**	2004
Realised / unrealised gains (losses) on trading securities		
Equities (a)	**1,084**	307
Fixed income and other (b)	**(189)**	340
Total	**895**	647

(a) Includes equity securities and equity derivatives.

(b) Includes bonds, commercial paper, interest rate and foreign exchange derivatives.

Trading assets

The following table presents the fair value of trading assets and liabilities:

31 December	2005	2004
Debt and equity instruments		
Certificates of deposit, bankers acceptances and commercial paper	86,185	628,147
Debt securities issued by non-US governments	10,631	12,475
Corporate securities and other	39,704	3,273
Total net trading	136,520	643,895

Available for sale

The following table presents realised gains and losses from available for sale securities:

31 December	2005	2004
Realised gains	90	362
Realised losses	–	–
Net realised gains	90	362

The amortised cost and estimated fair value of available for sale and held to maturity securities were as follows:

	2005				2004			
31 December	Amortised cost	Gross unrealised gains	Gross unrealised losses	Fair value	Amortised cost	Gross unrealised gains	Gross unrealised losses	Fair value
Available for sale								
Debt securities issued by non-US governments	42,669	–	–	42,669	–	–	–	–
Corporate debt securities	468,996	67	(134)	468,929	26,304	–	–	26,304
Equity securities	301	–	–	301	2,890	264	–	3,154
Other, primarily asset-backed securities	34,400	3	–	34,403	223	–	–	223
Total available for sale	546,366	70	(134)	546,302	29,417	264	–	29,681
Held to maturity								
US government and federal agencies/corporations	96,628	99	(716)	96,011	85,421	364	(36)	85,749
Collateralised mortgage obligations	151,135	106	(157)	151,084	242,249	111	(378)	241,982
Debt securities issued by non-US governments	93,517	177	(703)	92,991	57,246	228	(4)	57,470
Corporate debt securities	1,662,515	1,315	(2,662)	1,661,168	2,023,810	3,560	(1,363)	2,026,007
Other, primarily asset-backed securities	229,782	124	(11,117)	218,789	184,098	335	(8,452)	175,981
Total held to maturity	2,233,577	1,821	(15,355)	2,220,043	2,592,824	4,598	(10,233)	2,587,189

Investments at carrying value includes $1,738,105 (2004: $2,521,170) of floating-rate instruments and $1,144,491 (2004: $707,165) of fixed-rate instruments. The approximate yield on floating rate securities at 31 December 2005 was 4.36% (2004: 2.69%), while the approximate yield on fixed rate securities was 4.46% (2004: 5.31%).

Financials

The following table presents securities by remaining term to maturity:

31 December 2005	Within 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity	Carrying value
			Remaining term to maturity			
Available for sale						
Debt securities issued by non-US governments	33,226	–	9,443	–	–	42,669
Corporate debt securities	207,094	260,185	–	1,650	–	468,929
Equity securities	–	–	–	–	301	301
Other, primarily asset-backed securities	–	34,403	–	–	–	34,403
Total available for sale	240,320	294,588	9,443	1,650	301	546,302
Held to maturity						
US government and federal agencies / corporations	–	–	59,950	36,678	–	96,628
Collateralised mortgage obligations	–	–	–	151,134	–	151,134
Debt securities issued by non-US governments	5,003	3,178	71,761	13,576	–	93,518
Corporate debt securities	161,603	266,427	1,229,485	5,000	–	1,662,515
Other, primarily asset-backed securities	–	–	48,888	180,894	–	229,782
Total held to maturity	166,606	269,605	1,410,084	387,282	–	2,233,577
Trading						
Certificates of deposit, bankers acceptances and commercial paper	73,285	12,901	–	–	–	86,186
Debt securities issued by non-US governments	–	828	2,126	7,677	–	10,631
Corporate securities and other	219	–	692	–	38,792	39,703
Total trading	73,504	13,729	2,818	7,677	38,792	136,520
Total investments	480,430	577,922	1,422,345	396,609	39,093	2,916,399
Total by currency (in Bermuda dollars equivalent)						
Bermuda dollars	61	–	–	–	800	861
US dollars	217,295	194,576	1,350,436	370,949	28,536	2,161,792
Other	263,074	383,346	71,909	25,660	9,757	753,746
Total investments	480,430	577,922	1,422,345	396,609	39,093	2,916,399

31 December 2004	Within 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity	Carrying value
			Remaining term to maturity			
Available for sale						
Corporate debt securities	24,934	–	–	1,370	–	26,304
Equity securities	–	–	–	–	3,154	3,154
Other, primarily asset-backed securities	–	–	–	–	223	223
Total available for sale	24,934	–	–	1,370	3,377	29,681
Held to maturity						
US government and federal agencies / corporations	19,983	20,191	–	45,248	–	85,422
Collateralised mortgage obligations	–	–	32,168	210,081	–	242,249
Debt securities issued by non-US governments	5,755	7,935	35,048	18,723	4,667	72,128
Corporate debt securities	379,834	318,226	1,300,871	9,984	–	2,008,915
Other, primarily asset-backed securities	–	–	37,617	120,523	25,970	184,110
Total held to maturity	405,572	346,352	1,405,704	404,559	30,637	2,592,824

	Remaining term to maturity					
31 December 2004	Within 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity	Carrying value
Trading						
Certificates of deposit, bankers acceptances and commercial paper	513,966	114,181	–	–	–	628,147
Debt securities issued by non-US governments	–	747	3,376	8,353	–	12,476
Corporate securities and other	–	–	–	–	3,272	3,272
Total trading	513,966	114,928	3,376	8,353	3,272	643,895
Total investments	944,472	461,280	1,409,080	414,282	37,286	3,266,400
Total by currency (in Bermuda dollars equivalent)						
Bermuda dollars	–	–	–	–	3,154	3,154
US dollars	339,861	289,273	1,326,445	379,236	32,448	2,367,263
Other	604,611	172,007	82,635	35,046	1,684	895,983
Total investments	944,472	461,280	1,409,080	414,282	37,286	3,266,400

NOTE 5: Loans

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

	2005			2004		
31 December	**Bermuda**	**Non-Bermuda**	**Total**	Bermuda	Non-Bermuda	Total
Commercial loans						
Commercial and industrial	**468,803**	**87,718**	**556,521**	375,390	121,765	497,155
Commercial real estate						
Commercial mortgage	**133,626**	**431,440**	**565,066**	61,500	306,186	367,686
Construction	**140,101**	**8,980**	**149,081**	134,839	5,164	140,003
Financial institutions	**321,383**	**58,156**	**379,539**	249,520	63,217	312,737
Government	**19,303**	**–**	**19,303**	24,853	13,983	38,836
Total commercial loans	**1,083,216**	**586,294**	**1,669,510**	846,102	510,315	1,356,417
Less allowance for credit losses on commercial loans	**(13,765)**	**(2,158)**	**(15,923)**	(10,588)	(3,051)	(13,639)
Total commercial loans after allowance for credit losses	**1,069,451**	**584,136**	**1,653,587**	835,514	507,264	1,342,778
Consumer loans						
Credit card	**38,990**	**18,254**	**57,244**	34,814	16,618	51,432
Automobile financing	**52,919**	**8,948**	**61,867**	47,099	8,102	55,201
Mortgages	**799,922**	**252,549**	**1,052,471**	702,200	207,562	909,762
Other consumer	**78,378**	**190,858**	**269,236**	73,881	222,459	296,340
Total consumer loans	**970,209**	**470,609**	**1,440,818**	857,994	454,741	1,312,735
Less allowance for credit losses on consumer loans	**(5,978)**	**(2,833)**	**(8,811)**	(5,578)	(4,604)	(10,182)
Total consumer loans after allowance for credit losses	**964,231**	**467,776**	**1,432,007**	852,416	450,137	1,302,553
Total loans	**2,053,425**	**1,056,903**	**3,110,328**	1,704,096	965,056	2,669,152
Less allowance for credit losses	**(19,743)**	**(4,991)**	**(24,734)**	(16,166)	(7,655)	(23,821)
Net loans	**2,033,682**	**1,051,912**	**3,085,594**	1,687,930	957,401	2,645,331

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 2005 is 6.37% (2004: 6.32%). During the year loans of nil (2004: $35 million) were purchased from other parties at fair value. The premium or discount over book value is amortised over the life of the loan.

The table below sets forth information about the Bank's impaired loans:

	2005			2004		
31 December	**Gross**	**Allowance**	**Total**	Gross	Allowance	Total
Commercial loans – Bermuda	**6,293**	**(2,625)**	**3,668**	2,557	(716)	1,841
Commercial loans – Non-Bermuda	**7,791**	**(729)**	**7,062**	9,019	(484)	8,535
Consumer loans – Bermuda	**900**	**(165)**	**735**	1,072	(237)	835
Consumer loans – Non-Bermuda	**2,700**	**(358)**	**2,342**	726	(374)	352
Mortgages – Bermuda	**4,597**	**(165)**	**4,432**	1,203	–	1,203
Mortgages – Non-Bermuda	**4,681**	**(62)**	**4,619**	5,895	(107)	5,788
Total	**26,962**	**(4,104)**	**22,858**	20,472	(1,918)	18,554

For the year ended 31 December 2005, the amount of gross interest income that would have been recorded had impaired loans been current was $2,711 (2004: $2,666). For the year ended 31 December 2005, the Bank recovered overdue interest of $529 (2004: $172) on impaired loans that were repaid in the year. The average balance of impaired loans during the year ended 31 December 2005 was $24,705 (2004: $18,429).

The table below summarises the changes in the allowance for credit losses:

	2005			2004		
Year ended 31 December	**Specific allowances**	**General allowance**	**Total**	Specific allowances	General allowance	Total
Allowance for credit losses at beginning of year	**1,918**	**21,903**	**23,821**	3,949	17,937	21,886
Provision this year	**4,464**	**(1,292)**	**3,172**	723	2,171	2,894
Recoveries	**255**	**1,195**	**1,450**	2,215	3,204	5,419
Charge-offs	**(2,528)**	**(1,176)**	**(3,704)**	(5,330)	(1,053)	(6,383)
Other	**(5)**	**–**	**(5)**	361	(356)	5
Allowance for credit losses at end of year	**4,104**	**20,630**	**24,734**	1,918	21,903	23,821

The table below presents information about the loan delinquencies, and charge-offs:

	2005			2004		
31 December	**Total delinquent loans**	**Loans 90 days or more past due**	**Charge-Offs**	Total delinquent loans	Loans 90 days or more past due	Charge-offs
Credit card	**4,198**	**845**	**897**	3,812	587	763
Automobile financing	**765**	**369**	**42**	872	569	554
Other consumer and mortgages	**22,637**	**11,798**	**2,431**	25,882	12,969	1,286
Consumer loans	**27,600**	**13,012**	**3,370**	30,566	14,125	2,603
Commercial loans	**6,433**	**5,127**	**334**	12,563	11,168	3,780
Total loans reported	**34,033**	**18,139**	**3,704**	43,129	25,293	6,383

NOTE 6: Credit Risk Concentrations

Concentrations of credit risk 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 also by geographic region. In the consumer portfolio, concentrations are primarily evaluated by products. Credit exposures includes loans, guarantees and acceptances, letters of credit and commitments for undrawn lines of credit.

The following table summarises the credit exposure of the Bank by business sector:

31 December	2005	2004
Primary industry and manufacturing	55,679	95,155
Commercial and merchandising	725,874	572,940
Real estate	967,681	1,340,454
Transport and communication	30,994	56,322
Bank and financial services	1,262,226	938,413
Governments	19,303	38,474
Individuals	1,378,195	944,747
Sub-total	4,439,952	3,986,505
General allowance	(20,630)	(21,903)
Total	4,419,322	3,964,602

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

31 December	2005	2004
Bermuda	3,029,684	2,752,005
Barbados	119,620	84,148
Cayman	444,276	428,962
Guernsey	324,196	225,902
The Bahamas	5,182	2,904
United Kingdom	516,994	492,584
Sub-total	4,439,952	3,986,505
General allowance	(20,630)	(21,903)
Total	4,419,322	3,964,602

NOTE 7: Premises, Equipment and Computer Software

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

	2005			2004		
31 December	Cost	Accumulated depreciation	Net carrying value	Cost	Accumulated depreciation	Net carrying value
Land	**11,997**	**–**	**11,997**	12,345	–	12,345
Buildings	**109,742**	**(28,403)**	**81,339**	105,907	(30,633)	75,274
Equipment	**42,925**	**(25,229)**	**17,696**	62,162	(47,281)	14,881
Computer software	**49,848**	**(19,172)**	**30,676**	62,610	(39,079)	23,531
Total	**214,512**	**(72,804)**	**141,708**	243,024	(116,993)	126,031

31 December	2005	2004
Depreciation		
Buildings and equipment (included in property expenses)	**6,633**	6,686
Computer software (included in systems and communication expenses)	**7,698**	6,334
Total depreciation charged to operating expenses	**14,331**	13,020

NOTE 8: Goodwill and Other Intangible Assets

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

Goodwill

Business segment	Barbados	Guernsey	The Bahamas	United Kingdom	Total
Balance as at 31 December 2003	5,220	3,014	892	–	9,126
Goodwill acquired during the year	–	4,758	1,031	8,937	14,726
Foreign exchange translation adjustment	–	419	–	367	786
Balance as at 31 December 2004	5,220	8,191	1,923	9,304	24,638
Foreign exchange translation adjustment	**–**	**(848)**	**–**	**(950)**	**(1,798)**
Balance as at 31 December 2005	**5,220**	**7,343**	**1,923**	**8,354**	**22,840**

Other intangible assets	2005			2004		
31 December	Gross carrying amount	Accumulated amortisation	Net carrying amount	Gross carrying amount	Accumulated amortisation	Net carrying amount
Bermuda	**8,337**	**(695)**	**7,642**	8,337	(139)	8,198
Barbados	**6,681**	**(926)**	**5,755**	6,681	(482)	6,199
Cayman	**1,211**	**(108)**	**1,103**	1,211	(27)	1,184
Guernsey	**45,491**	**(12,205)**	**33,286**	50,740	(10,202)	40,538
The Bahamas	**7,790**	**(1,465)**	**6,325**	7,790	(1,067)	6,723
United Kingdom	**17,905**	**(2,394)**	**15,511**	19,831	(1,268)	18,563
Customer relationships	**87,415**	**(17,793)**	**69,622**	94,590	(13,185)	81,405

There have been no impairment losses for the years ended 31 December 2005 and 2004. The estimated aggregate amortisation expense for each of the succeeding years until 31 December 2009 is $6.0 million. 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. During 2005, the Bank did not acquire new customer relationships (2004: $44.9 million), the amortisation expense amounted to $6.3 million (2004: $5.4 million) and the foreign exchange translation adjustment decreased the net carrying amount by $5.5 million (2004: increased by $3.2 million).

NOTE 9: Customer Deposits and Deposits from Banks

(a) By maturity

31 December	2005	2004
Customer and bank demand deposits		
Demand deposits – Non-interest bearing	**858,358**	999,826
Demand deposits – Interest bearing	**3,964,017**	3,878,707
Sub-total – demand deposits	**4,822,375**	4,878,533
Customer and bank term deposits		
Term deposits maturing within six months	**3,086,510**	2,690,114
Term deposits maturing between six to twelve months	**148,667**	105,695
Term deposits maturing after twelve months	**182,557**	233,108
Sub-total – term deposits	**3,417,734**	3,028,917
Total	**8,240,109**	7,907,450

(b) By type and location

	2005			2004		
31 December	**Payable on demand**	**Payable on a fixed date**	**Total**	Payable on demand	Payable on a fixed date	Total
Bermuda						
Customers	**1,970,607**	**1,243,597**	**3,214,204**	2,098,322	1,069,535	3,167,857
Banks	**8,069**	**24,831**	**32,900**	223,951	–	223,951
Cayman						
Customers	**1,522,129**	**689,696**	**2,211,825**	1,528,645	438,140	1,966,785
Banks	**55,185**	**75,994**	**131,179**	–	184,943	184,943
Guernsey						
Customers	**654,654**	**695,709**	**1,350,363**	524,102	756,042	1,280,144
Banks	**5,681**	**2,005**	**7,686**	5,711	488	6,199
Other international						
Customers	**594,803**	**577,771**	**1,172,574**	497,802	492,267	990,069
Banks	**11,247**	**108,131**	**119,378**	–	87,502	87,502
Total	**4,822,375**	**3,417,734**	**8,240,109**	4,878,533	3,028,917	7,907,450

The effective yield on deposits at 31 December 2005 was 2.6% (2004: 2.2%).

NOTE 10: 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 plans are non-contributory and the funding required is provided by the Bank, based upon the advice of an independent actuary.

Effective 1 September 2000, the Bank implemented a defined contribution pension plan for its Bermuda based employees. Funding of the plan is determined based upon the provisions of the plan and is shared with the employees. All employees under age 45 were transferred into this plan. All Bermuda based employees joining the Bank after this date will automatically join this defined contribution plan.

Substantially all of the pension assets are invested in equity, fixed income and other marketable securities.

The following table presents the financial position of the Bank's defined benefit pension plans and the Bank's post-retirement medical benefit plan. The benefit obligations and plan assets are measured as at 30 November.

	2005		2004	
	Pension plans	**Post-retirement medical benefit plan**	Pension plans	Post-retirement medical benefit plan
Accumulated benefit obligation at end of year	**103,713**	**–**	98,084	–
Change in projected benefit obligation				
Opening projected benefit obligation	**105,515**	**82,524**	77,093	75,821
Acquisitions	**–**	**–**	21,610	–
Service cost	**3,748**	**2,256**	4,443	1,472
Employee contributions	**272**	**–**	180	–
Interest cost	**5,729**	**5,572**	5,278	4,755
Benefits paid	**(3,650)**	**(1,257)**	(3,496)	(560)
Past service cost	**–**	**–**	221	–
Actuarial loss (gain)	**5,342**	**8,150**	(2,002)	1,036
Foreign currency exchange rate changes	**(4,728)**	**–**	2,188	–
Closing projected benefit obligation	**112,228**	**97,245**	105,515	82,524
Change in plan assets				
Opening fair value of plan assets	**86,448**	**–**	66,352	–
New acquisitions	**–**	**–**	15,524	–
Actual return on plan assets	**8,461**	**–**	3,427	–
Employer contribution	**9,348**	**1,257**	2,830	560
Employee contributions	**272**	**–**	180	–
Benefits paid	**(3,650)**	**(1,257)**	(3,496)	(560)
Foreign currency exchange rate changes	**(3,619)**	**–**	1,631	–
Closing fair value of plan assets	**97,260**	**–**	86,448	–
Funded status				
Deficit of plan assets over projected benefit obligation at end of year	**(14,968)**	**(97,245)**	(19,067)	(82,524)
Employer contribution during the period from measurement date to fiscal year end	**5,176**	**–**	255	–
Unamortised net actuarial loss	**4,854**	**41,048**	2,138	36,874
Unamortised past service cost	**146**	**–**	201	–
Net amount recognised	**(4,792)**	**(56,197)**	(16,473)	(45,650)

	2005		2004	
	Pension plans	**Post-retirement medical benefit plan**	Pension plans	Post-retirement medical benefit plan
Amounts recognised in balance sheet consist of				
Prepaid pension benefit cost included in other assets	**180**	**–**	–	–
Accrued pension benefit cost included in other liabilities	**(5,376)**	**(56,197)**	(16,473)	(45,650)
Accumulated other comprehensive income	**404**	**–**	–	–
Net amount recognised	**(4,792)**	**(56,197)**	(16,473)	(45,650)
Annual benefit expense				
Service cost	**3,748**	**2,256**	4,443	1,472
Interest cost	**5,729**	**5,572**	5,278	4,755
Expected return on plan assets	**(5,733)**	**–**	(5,046)	–
Amortisation of past service cost	**36**	**–**	28	–
Amortisation of actuarial (gain) loss	**(71)**	**3,976**	21	3,175
Defined benefit expense	**3,709**	**11,804**	4,724	9,402
Defined contribution expense	**3,378**	**–**	3,121	–
Total benefit expense	**7,087**	**11,804**	7,845	9,402

	2005		2004	
December 31	**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	**5.60%**	**6.00%**	5.75%	6.25%
Weighted average rate of compensation increases	**3.70%**	**N/A**	4.15%	N/A
Weighted average expected long-term rate of return on plan assets	**6.50%**	**N/A**	6.55%	N/A
Weighted average annual medical cost increase rate	**N/A**	**12% to 5% in 2013**	N/A	12% to 5% in 2011
Actuarial assumptions used to determine benefit obligations at end of year				
Weighted average discount rate	**5.45%**	**6.00%**	5.60%	6.00%
Weighted average rate of compensation increases	**3.80%**	**N/A**	3.70%	N/A
Weighted average annual medical cost increase rate	**N/A**	**11% to 5% in 2013**	N/A	11% to 5% in 2011

For 2005, 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 $1.6 million increase and a $1.2 million decrease, respectively, and on the benefit obligation a $16.8 million increase and a $13.6 million decrease, 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 actual and target asset allocations of the pension plans by asset category, are as follows:

	2005		2004	
31 December	**Actual allocation**	**Target allocation**	Actual allocation	Target allocation
Asset category				
Equity securities (including equity mutual funds)	**55%**	**50%**	57%	51%
Debt securities (including debt mutual funds)	**40%**	**50%**	37%	49%
Other	**5%**	**–**	6%	–
Total	**100%**	**100%**	100%	100%

At 31 December 2005, 52.6% (2004: 50.8%) of the assets of the pension plans were mutual funds and alternative investments managed or administered by wholly-owned subsidiaries of the Bank. At 31 December 2005, 2.0% (2004: 1.8%) of these mutual funds' assets were invested in common shares of the Bank.

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 2006 Bank contribution to, and estimated benefit payments for the next ten years under, the pension and post-retirement medical benefit plans are as follows:

	Year	Pension plans	Post-retirement medical benefit plan
Estimated Bank contributions	2006	5,400	2,760
Estimated benefit payments	2006	3,400	2,760
Estimated benefit payments	2007	3,700	3,087
Estimated benefit payments	2008	3,900	3,510
Estimated benefit payments	2009	4,000	3,925
Estimated benefit payments	2010	4,300	4,363
Estimated benefit payments	2011-2015	27,500	27,598

The projected benefit obligation and fair value of plan assets for pension plans with projected benefit obligations in excess of plan assets were $110 million and $94 million respectively, as at 31 December 2005 ($103 million and $84 million respectively, as at 31 December 2004).

NOTE 11: Commitments, Credit Related Arrangements and Contingencies

Commitments

The Bank was committed to expenditures under contract for software development and construction of $5.4 million and $29.5 million respectively, as at 31 December 2005 (2004: $8.7 million and $25 million). Rental expense for premises leased on a long-term basis for the year ended 31 December 2005 amounted to $5.1 million (2004: $4.9 million).

The following table summarises the Bank's commitments for construction, software development and long-term leases:

Year	
2006	27,464
2007	17,445
2008	4,712
2009	4,560
2010	4,243
2011 & thereafter	5,652

Credit Related Arrangements

The following table presents the credit related arrangements with contractual amounts representing credit risk as follows:

	2005			2004		
31 December	**Gross**	**Collateral**	**Net**	Gross	Collateral	Net
Commitments to extend credit	**775,689**	**245,875**	**529,814**	650,973	156,106	494,867
Commitments to invest	**–**	**–**	**–**	2,464	2,464	–
Letters of credit						
Standby	**560,419**	**529,593**	**30,826**	544,587	515,432	29,155
Documentary and commercial	**2,324**	**2,324**	**–**	3,025	2,599	426
Guarantees	**37,441**	**32,347**	**5,094**	15,296	11,074	4,222
Forward guarantees	**2,846**	**2,846**	**–**	2,151	2,151	–
Total	**1,378,719**	**812,985**	**565,734**	1,218,496	689,826	528,670

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

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, while the term of the guarantees does not exceed four years. The types and amounts of collateral security held by the Bank for these standby letters of credit and guarantees is generally represented by deposits with the Bank or a charge over assets held in mutual funds.

During the year, the Bank was provided with a facility by one of its custodians, whereby the Bank may offer up to $150 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 of set-off against securities held of 110% of the utilised facility. At 31 December 2005, $20.4 million (2004: nil) of standby letters of credit were issued under this facility.

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 12: Interest Income

Loans

The following table presents the components of loan interest income:

Year ended 31 December	2005	2004
Mortgages	**85,134**	68,212
Other loans	**95,201**	63,203
	180,335	131,415
Amortisation of loan origination fees (net of amortised costs)	**3,580**	2,222
Total loan interest income	**183,915**	133,637
Balance of unamortised loan fees as at 31 December	**10,843**	9,195

NOTE 13: Segmented Information

(a) Operating Segments: For management reporting purposes, the operations of the Bank are grouped into the following nine business segments based upon the geographic location of the Bank's operations: Bermuda (which is further sub-divided based on products and services into Community Banking, Wealth Management & Fiduciary Services and Investment & Pension Fund Administration, and Real Estate), Barbados, Cayman, Guernsey, The Bahamas, the United Kingdom, and Hong Kong. Accounting policies of the reportable segments are the same as those described in Note 1.

The Bermuda Community Banking segment provides a full range of retail, corporate and treasury 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. Corporate services include commercial lending and mortgages, cash management, payroll services, remote banking, and letters of credit. Treasury services include money market and foreign exchange activities. Community Banking also includes treasury operations and Promisant (Technology) Limited.

The Bermuda Wealth Management & Fiduciary Services and Investment & Pension Fund Administration segment consists of Butterfield Asset Management Limited, which provides investment management, advisory and brokerage services, Butterfield Trust (Bermuda) Limited which provides trust, estate, company management and custody services, and Butterfield Fund Services Limited, which provides valuation, accounting, corporate and shareholder services.

The Real Estate segment consists of the Bank's investments in real estate and all related costs. This segment also includes rental revenues from third parties.

The Barbados segment provides a range of community and commercial banking services through four branch locations, ATMs and debit cards. Services include deposit services, commercial banking, consumer and mortgage lending and credit cards.

The Cayman segment provides a comprehensive range of community and commercial banking services to private and corporate customers through five locations and through internet banking, ATMs and debit cards. Wealth management and fiduciary services and investment and pension fund administration 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 and investment and pension fund administration services.

The Bahamas segment provides institutional, corporate and private clients with a range of wealth management & fiduciary services and investment fund administration 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 Hong Kong segment provides investment and pension fund administration and custody services and represents the Bank's 20% investment in RBC Dexia Investor Services Limited (formerly Dexia Holdings (Hong Kong) Limited).

Operating segment information follows:

31 December	2005	2004
Total Assets		
Bermuda		
Community Banking	**4,459,464**	4,176,846
Wealth Management & Fiduciary Services and Investment & Pension Fund Administration	**32,432**	28,952
Real Estate	**76,265**	65,082
Total Bermuda	**4,568,161**	4,270,880
Barbados	**194,433**	173,324
Cayman	**2,579,080**	2,322,657
Guernsey	**1,495,284**	1,442,522
The Bahamas	**96,903**	63,433
United Kingdom	**1,206,154**	1,096,629
Hong Kong	**233**	2,076
Total overseas	**5,572,087**	5,100,641
Less: inter-segment eliminations	**(942,682)**	(741,138)
Total	**9,197,566**	8,630,383

Business Area Analysis

Year ended 31 December 2005	Net interest income Customer	Net interest income Intersegment	Allowance for credit losses	Fees and other income	Total revenue	Other expenses	Depreciation & amortisation	Total expenses	Net income
Bermuda									
Community Banking	112,658	(5,730)	(4,513)	28,285	130,700	96,893	5,709	102,602	28,098
Wealth Management & Fiduciary Services and Investment & Pension Fund Administration	–	342	–	67,692	68,034	35,907	1,160	37,067	30,967
Real Estate	–	(1,115)	–	2,518	1,403	5,692	1,925	7,617	(6,214)
Sub-total Bermuda	112,658	(6,503)	(4,513)	98,495	200,137	138,492	8,794	147,286	52,851
Barbados	7,934	–	(255)	3,495	11,174	8,136	1,595	9,731	1,443
Cayman	37,345	6,717	1,622	36,520	82,204	33,454	2,935	36,389	45,815
Guernsey	10,993	1,652	–	27,493	40,138	28,622	4,310	32,932	7,206
The Bahamas	(301)	1,354	(26)	5,763	6,790	4,476	659	5,135	1,655
United Kingdom	16,717	(3,220)	–	9,058	22,555	20,284	2,529	22,813	(258)
Hong Kong	–	–	–	639	639	–	–	–	639
Sub-total overseas	72,688	6,503	1,341	82,968	163,500	94,972	12,028	107,000	56,500
Total income	185,346	–	(3,172)	181,463	363,637	233,464	20,822	254,286	109,351
Less: inter-segment eliminations (principally rent and management fees)	–	–	–	(8,508)	(8,508)	(8,508)	–	(8,508)	–
Total	185,346	–	(3,172)	172,955	355,129	224,956	20,822	245,778	109,351

Year ended 31 December 2004	Net interest income Customer	Net interest income Intersegment	Allowance for credit losses	Fees and other income	Total revenue	Other expenses	Depreciation & amortisation	Total expenses	Net income
Bermuda									
Community Banking	94,275	363	1,437	38,941	135,016	82,479	5,388	87,867	47,149
Wealth Management & Fiduciary Services and Investment & Pension Fund Administration	–	249	–	55,357	55,606	27,531	706	28,237	27,369
Real Estate	–	(1,114)	–	2,515	1,401	5,632	1,581	7,213	(5,812)
Sub-total Bermuda	94,275	(502)	1,437	96,813	192,023	115,642	7,675	123,317	68,706
Barbados	5,608	(6)	(721)	3,576	8,457	6,572	1,561	8,133	324
Cayman	29,037	1,835	(3,582)	28,972	56,262	28,767	2,775	31,542	24,720
Guernsey	7,378	1,649	–	26,015	35,042	29,273	3,193	32,466	2,576
The Bahamas	131	389	(28)	5,369	5,861	4,454	739	5,193	668
United Kingdom	14,540	(3,365)	–	8,137	19,312	24,081	2,447	26,528	(7,216)
Hong Kong	–	–	–	688	688	–	–	–	688
Sub-total overseas	56,694	502	(4,331)	72,757	125,622	93,147	10,715	103,862	21,760
Total income	150,969	–	(2,894)	169,570	317,645	208,789	18,390	227,179	90,466
Less: inter-segment eliminations (principally rent and management fees)	–	–	–	(6,480)	(6,480)	(6,480)	–	(6,480)	–
Total	150,969	–	(2,894)	163,090	311,165	202,309	18,390	220,699	90,466

For the year ended 31 December 2005, included within other expenses are the following income tax expense / (refund) amounts: Guernsey $984 (2004: ($376)), United Kingdom $60 (2004: ($1,551)), and Barbados $584 (2004: $192). Transactions between operating segments principally include interbank deposits and rent which are recorded based upon market rates, and management fees, which are recorded based on the cost of the services provided.

(b) Revenues by Products and Services: The principal sources of revenues by products and services are disclosed separately in the Consolidated Statement of Income.

NOTE 14: Accounting for Derivative Instruments and Risk Management

The Bank uses derivatives in the asset and liability management (ALM) of positions and to assist customers with their risk management objectives. 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.

The Bank's derivative contracts principally involve over the counter transactions that are privately negotiated between the Bank and the counterparty to the contract. Derivative instruments that are used as part of the Bank's interest rate risk management strategy include interest rate swaps and option 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. Interest rate options represent contracts that allow the holder of the option to receive cash or purchase, sell, or enter into a financial instrument at a specified price within a specified period.

The Bank pursues 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.

Included in other assets (other liabilities) are the reported receivables and unrealised gains (payables and unrealised losses) related to derivatives. These amounts include the effect of netting as permitted under FASB Interpretation No. 39 Offsetting Amounts Related to Certain Contracts (FIN 39).

(a) Fair Value Hedges

The Bank enters into interest rate swaps to convert its fixed rate long term debt to floating rate debt, and convert fixed rate deposits to floating rate deposits. For the year ended 31 December 2005 the Bank recognised a net loss of $0.4 million (2004: $0.2 million) reported as other income in the Consolidated Statement of Income, which represented the ineffective portion of all fair-value hedges. As of 31 December 2005 the Bank has recorded the fair value of derivative instrument assets of $1.3 million (2004: $0.4 million) in other assets and derivative instrument liabilities of $7.2 million (2004: $3.2 million) in other liabilities.

(b) Cash Flow Hedges

The Bank uses interest rate swaps to convert floating-rate notes to fixed-rate instruments. These swaps, which qualify for hedge accounting, have the pay rate indexed to the rates received on the Bank's variable-rate assets and the receive rate indexed to rates paid on the Bank's various deposit liabilities.

For cash flow hedges, gains and losses on derivative contracts that are reclassified from accumulated other comprehensive income to current-period earnings are included in the line item in which the hedged item is recorded in the same period the forecasted transaction affects earnings. As at 31 December 2005 and 2004, there was no hedge ineffectiveness related to cash flow hedges. As of 31 December 2005, ($0.5) million (2004: $1.9 million) of the deferred net gains on derivative instruments accumulated in other comprehensive income are expected to be reclassified as earnings during the next twelve months. The maximum term over which the Bank is hedging its exposure to the variability of future cash flows is 2 years (2004: 3 years). As of 31 December 2005, the Bank has recorded the fair value of derivative instrument assets of $0.2 million (2004: $2.9 million) in other assets and $1.5 million (2004: $1.4 million) in other liabilities.

Notional Amounts: The following table provides the aggregate notional amounts of derivative contracts outstanding listed by type and divided between those used for trading (non-hedging) and those used in hedging activities. 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.

		2005			2004	
31 December	**Trading**	**ALM**	**Total value**	Trading	ALM	Total value
Interest rate contracts						
Interest rate swaps	**26,748**	**444,204**	**470,952**	59,593	595,320	654,913
Interest rate caps	**52,332**	**–**	**52,332**	66,000	–	66,000
Sub-total	**79,080**	**444,204**	**523,284**	125,593	595,320	720,913
Foreign exchange contracts						
Spot and forwards	**5,604,472**	**–**	**5,604,472**	2,415,658	–	2,415,658
Currency options	**–**	**–**	**–**	5,130	–	5,130
Sub-total	**5,604,472**	**–**	**5,604,472**	2,420,788	–	2,420,788
Total notional amount of financial derivatives outstanding	**5,683,552**	**444,204**	**6,127,756**	2,546,381	595,320	3,141,701

Included in the notional amounts for cash flow hedges using interest rate swaps for 31 December 2005, are $225.2 million (2004: $372.8 million), pertaining to specific floating rate notes included in the investment portfolio which were classified as held to maturity, and $12.9 million (2004: nil) pertaining to floating rate deposits. Included in the notional amounts for fair value hedges using interest rate swaps for 2005, are $51.2 million (2004: $29.8 million) pertaining to specific loans, $125 million (2004: $125 million) pertaining to subordinated debt, and $42.8 million (2004: $24.5 million), pertaining to fixed rate deposits.

(c) 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, such that previously contracted derivative transactions have become more or less favourable than what can be negotiated under current market conditions for contracts with the same remaining period to maturity. 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 following table shows the marked to market fair value of all derivative contracts outstanding. This is defined as the profit (loss) associated with replacing the derivative contracts at prevailing market prices.

		2005			2004	
31 December	**Positive**	**Negative**	**Net**	Positive	Negative	Net
Derivative financial instruments						
Interest rate swaps	**1,519**	**8,740**	**(7,221)**	3,690	4,271	(581)
Spot and forward foreign exchange	**26,318**	**24,613**	**1,705**	26,555	23,734	2,821
Interest rate caps and currency options	**1,136**	**1,070**	**66**	506	477	29
Total fair value	**28,973**	**34,423**	**(5,450)**	30,751	28,482	2,269

(d) Remaining Maturity

The following table summarises the remaining term to maturity of the notional amounts of the Bank's derivative instruments by type:

31 December 2005	Within 6 months	6 to 12 months	1 to 3 years	3 to 5 years	After 5 years	Total
Interest rate contracts						
Interest rate swaps	158,310	78,380	130,663	22,157	81,443	470,953
Interest rate caps	–	24,000	17,440	10,892	–	52,332
Sub-total	**158,310**	**102,380**	**148,103**	**33,049**	**81,443**	**523,285**
Foreign exchange contracts						
Spot and forwards	5,560,957	39,891	3,624	–	–	5,604,472
Currency options	–	–	–	–	–	–
Sub-total	**5,560,957**	**39,891**	**3,624**	**–**	**–**	**5,604,472**
Total notional amount by remaining maturity	**5,719,267**	**142,271**	**151,727**	**33,049**	**81,443**	**6,127,757**

31 December 2004	Within 6 months	6 to 12 months	1 to 3 years	3 to 5 years	After 5 years	Total
Interest rate contracts						
Interest rate swaps	97,373	111,511	275,797	100,659	69,573	654,913
Interest rate caps	–	–	66,000	–	–	66,000
Sub-total	**97,373**	**111,511**	**341,797**	**100,659**	**69,573**	**720,913**
Foreign exchange contracts						
Spot and forwards	2,280,033	124,496	11,129	–	–	2,415,658
Currency options	–	5,130	–	–	–	5,130
Sub-total	**2,280,033**	**129,626**	**11,129**	**–**	**–**	**2,420,788**
Total notional amount by remaining maturity	**2,377,406**	**241,137**	**352,926**	**100,659**	**69,573**	**3,141,701**

(e) Replacement Cost

The following table reflects the replacement cost of all derivative contracts outstanding. This is defined as the cost of replacing, at current market rates, all contracts that have a positive fair value before factoring in the impact of master netting agreements. The replacement cost of an instrument is dependent upon its terms relative to prevailing market prices and will fluctuate as market prices change and as the derivative approaches its scheduled maturity.

		2005			2004	
31 December	**Trading**	**ALM**	**Total value**	Trading	ALM	Total value
Interest rate contracts						
Interest rate swaps	**156**	**1,364**	**1,520**	–	3,690	3,690
Interest rate caps	**1,136**	**–**	**1,136**	305	–	305
Sub-total	**1,292**	**1,364**	**2,656**	305	3,690	3,995
Foreign exchange contracts						
Spot and forwards	**26,318**	**–**	**26,318**	26,555	–	26,555
Currency options	**–**	**–**	**–**	201	–	201
Sub-total	**26,318**	**–**	**26,318**	26,756	–	26,756
Total replacement cost	**27,610**	**1,364**	**28,974**	27,061	3,690	30,751

NOTE 15: Fair Value of Financial Instruments

The following table presents the carrying value and fair value of financial assets and liabilities under FAS No. 107 Disclosures About Fair Value of Financial Instruments (FAS No. 107). Accordingly, certain amounts which are not considered financial instruments are excluded from the table. For investments with an indicator of impairment, management have considered the available evidence, including discussions with rating agencies. Based on this and because the Bank has the ability and the intent to hold such securities to maturity, the Bank believes it will recover the full carrying value of the security. Should specific circumstances dictate that the Bank may not be able to hold such securities to maturity, such as a significant deterioration of credit worthiness of the issuer, the Bank may reassess whether a market value below carrying value represents an other than temporary impairment.

		2005			2004	
31 December	**Carrying value**	**Fair value**	**Appreciation / (depreciation)**	Carrying value	Fair value	Appreciation / (depreciation)
Financial assets						
Cash and deposits with banks	**2,849,920**	**2,849,920**	**–**	2,396,724	2,396,724	–
Investments						
Held to maturity	**2,233,577**	**2,220,043**	**(13,534)**	2,592,824	2,587,189	(5,635)
Available for sale	**546,302**	**546,302**	**–**	29,681	29,681	–
Trading	**136,520**	**136,520**	**–**	643,895	643,895	–
Loans						
Commercial, net of allowance for credit losses	**1,653,587**	**1,653,265**	**(322)**	1,342,778	1,343,503	725
Consumer, net of allowance for credit losses	**1,432,007**	**1,432,443**	**436**	1,302,553	1,304,684	2,131
Other assets	**345,653**	**345,653**	**–**	321,928	321,928	–
Total financial assets	**9,197,566**	**9,184,146**	**(13,420)**	8,630,383	8,627,604	(2,779)
Financial liabilities						
Customer deposits						
Demand deposits	**4,742,193**	**4,742,193**	**–**	4,633,654	4,633,654	–
Term deposits	**3,206,773**	**3,209,043**	**(2,270)**	2,771,201	2,762,101	9,100
Deposits, financial institutions	**291,143**	**291,143**	**–**	502,595	502,595	–
Other liabilities	**183,552**	**183,552**	**–**	152,570	152,570	–
Subordinated capital and senior debt	**278,679**	**275,408**	**3,271**	142,333	142,333	–
Total financial liabilities	**8,702,340**	**8,701,339**	**1,001**	8,202,353	8,193,253	9,100

NOTE 16: Interest Rate Risk

The following table sets out the assets, liabilities and off-balance sheet instruments on the date of the earlier of contractual 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, and certain investments which have call or pre-payment features.

	Earlier of contractual maturity or repricing date						
31 December 2005 (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 demand deposits with banks	**1,943**	**810**	**58**	**–**	**–**	**39**	**2,850**
Investments	**1,745**	**353**	**355**	**368**	**56**	**39**	**2,916**
Loans	**2,948**	**26**	**9**	**118**	**21**	**(36)**	**3,086**
Premises, equipment and computer software	**–**	**–**	**–**	**–**	**–**	**142**	**142**
Other assets	**–**	**–**	**–**	**–**	**–**	**204**	**204**
Total assets	**6,636**	**1,189**	**422**	**486**	**77**	**388**	**9,198**
Liabilities							
Shareholders' equity	**–**	**–**	**–**	**–**	**–**	**495**	**495**
Deposits	**6,183**	**913**	**103**	**144**	**39**	**858**	**8,240**
Other liabilities	**–**	**–**	**–**	**–**	**–**	**184**	**184**
Subordinated capital and senior debt (a)	**125**	**–**	**–**	**90**	**69**	**(5)**	**279**
Total liabilities	**6,308**	**913**	**103**	**234**	**108**	**1,532**	**9,198**
Interest rate sensitivity gap	**328**	**276**	**319**	**252**	**(31)**	**(1,144)**	**–**
Cumulative interest rate sensitivity gap	**328**	**604**	**923**	**1,175**	**1,144**	**–**	**–**

	Earlier of contractual maturity or repricing date						
31 December 2004 (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 demand deposits with banks	2,131	64	38	–	–	164	2,397
Investments	945	461	1,404	408	43	5	3,266
Loans	2,427	12	11	99	87	9	2,645
Premises, equipment and computer software	–	–	–	–	–	126	126
Other assets	–	–	–	–	–	196	196
Total assets	5,503	537	1,453	507	130	481	8,630
Liabilities							
Shareholders' equity	–	–	–	–	–	428	428
Deposits	6,464	138	94	210	–	1,001	7,907
Other liabilities	–	–	–	–	–	153	153
Subordinated capital (a)	(2)	–	–	–	144	–	142
Total liabilities	6,462	138	94	210	144	1,582	8,630
Interest rate sensitivity gap	(959)	399	1,359	297	(14)	(1,082)	–
Cumulative interest rate sensitivity gap	(959)	(560)	799	1,096	1,082	–	–

(a) Includes interest rate swaps with fair value of ($4.9 million) (2004: ($2 million)), that are highly effective, designated and qualify as fair value hedges.

NOTE 17: Subordinated Capital and Senior Debt

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 pays a fixed coupon of 3.94% until 27 May 2008 when they become redeemable in whole at the option of the Bank. The Series B notes pays a fixed coupon of 5.15% until 27 May 2013 when they also become redeemable in whole at the Bank's option. The Series A notes were priced at a spread of 1.25% over the 5-year US Treasury yield and 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 $8.6 million. The issuance was by way of private placement in the United Kingdom and pays a fixed coupon of 9.29% until April 2012 when it becomes redeemable in whole at the option of the Bank and 10.29% thereafter until August 2017.

On 5 April 2004, as part of the consideration to the shareholders of Leopold Joseph, the Bank's UK subsidiary, the Bank of Butterfield (UK) Limited issued senior debt of £5.2 million which was included in the Consolidated Balance Sheet in the amount of $10 million. The issue was exclusively to the shareholder's of Leopold Joseph and paid a variable rate of interest of 3 months LIBOR plus 30 basis points. The debt was repaid in full on 4 January 2005.

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 pays a fixed coupon of 4.81% until 2 July 2010, when they will become redeemable in whole at the Bank's option. The Series B notes pays 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.

Interest capitalised in accordance with FAS 34 during the year amounted to $1,165 (2004: $461) and is included in interest expense – subordinated capital and senior debt in the Consolidated Statement of Income.

The following table presents the contractual maturity and interest payments for subordinated capital issued by the Bank as at 31 December 2005:

		Within 1 year	1 to 5 years	After 5 years	Carrying value
Subordinated capital					
Bermuda					
2003 issuance – Series A	Fixed rate	3,073	90,293	7,683	78,000
2003 issuance – Series B	Fixed rate	2,421	9,682	65,154	47,000
2005 issuance – Series A	Fixed rate	4,377	107,316	21,645	90,000
2005 issuance – Series B	Fixed rate	3,100	12,264	90,660	60,000
Subsidiary	Fixed rate	799	3,195	14,222	8,600
Other (a)	–	–	–	–	(4,921)
Total		13,770	222,750	199,364	278,679

(a) Other includes interest rate swaps with notional amount of $125 million, that are highly effective, designated and qualify as fair value hedges.

NOTE 18: Earnings per Share

Earnings per share has been calculated using the weighted average number of shares outstanding during the year after deduction of the shares held as treasury stock and adjusted for the stock dividends declared during the year ended 31 December 2005 and 2004 (see also Note 22). The dilutive effect of stock options was calculated using the treasury stock method, whereby the proceeds received from the exercise of stock options are assumed to be used to repurchase outstanding shares, using the average market price of the Bank's shares for the period.

31 December	2005	2004
Basic earnings per share		
Net income for the year	109,351	90,466
Weighted average number of common shares issued (in thousands)	26,830	26,882
Weighted average number of common shares held as treasury stock (in thousands)	(1,632)	(1,862)
Adjusted weighted average number of common shares (in thousands)	25,198	25,020
	4.34	3.62

31 December	2005	2004
Diluted earnings per share		
Net income for the year	109,351	90,466
Average number of common shares issued (in thousands)	26,830	26,882
Average number of common shares held as treasury stock (in thousands)	(1,632)	(1,862)
Stock options (in thousands)	674	736
Adjusted weighted average number of diluted common shares (in thousands)	25,872	25,756
	4.23	3.51

NOTE 19: Stock Option Plan

At the Annual General Meeting of Shareholders held on 29 October 1997, the directors were granted authority to implement a Stock Option Plan for directors and employees.

Under the Bank's 1997 Stock Option Plan (the 1997 Plan), options to purchase common shares of the Bank may be granted 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. Subscription prices are stated and payable in Bermuda dollars for the options. Generally, grants vest 25 percent at the end of each year for four years. The committee that administers the 1997 Plan has the discretion to vary the period during which the holder has the right to exercise options and, in certain circumstances, may accelerate the right of the holder to exercise options, but in no case shall the exercise period exceed ten years.

The current maximum number of common shares reserved for issuance by the Board of Directors of the Company under the 1997 Plan is 3,000,000.

On 12 December 2005, the Board of Directors of the Bank approved the acceleration of the vesting of all outstanding unvested stock options (the Acceleration) for certain classes of employees. The Acceleration was effective for all such options outstanding on 25 November 2005, all of which were granted by the Bank when the accounting rules permitted use of the intrinsic value method of accounting for stock options. All of the other terms and conditions applicable to such outstanding stock option grants still apply. Under Accounting Principles Board Opinion No. 25 Accounting for Stock Issued to Employees (APB 25), the Acceleration resulted in recognition of stock-based compensation expense of $0.3 million which was determined by measuring the intrinsic value on the date of the modification of the options that otherwise would have expired unexercised. The Company's decision to accelerate the vesting of these options was made to reduce administrative burden and in anticipation of compensation expense to be recorded in connection with outstanding unvested stock options issued to employees subsequent to the effective date of FAS No. 123 (Revised 2004) Share Based Payment (FAS 123R).

The compensation expense that would have been recognised in the income statements for the years 2006 to 2009 as a result of the adoption of FAS 123R had the Acceleration not taken place is $0.7 million. As a result of the Acceleration, options to purchase 206,588 shares of the Bank's common stock became immediately exercisable.

At 31 December 2005, the Bank held as treasury stock 1,519,203 shares (2004: 1,556,476) that will be used to satisfy the Bank's obligations with respect to the Stock Option Plan.

Directors' and Executive Officers' Stock Option Plan	2005		2004	
31 December	Number of stock options	Weighted average exercise price ($)	Number of stock options	Weighted average exercise price ($)
Outstanding at beginning of year	**520,229**	**25.47**	385,471	20.87
Granted	**129,425**	**38.48**	117,211	40.18
Stock dividend granted	**60,937**	**26.42**	45,616	24.92
Exercised	**(95,893)**	**15.98**	(28,069)	22.94
Forfeited / cancelled	**–**	**–**	–	–
Outstanding at end of year	**614,698**	**27.82**	520,229	25.47
Vested and exercisable at end of year	**311,265**	**20.81**	290,888	18.66

Characteristics of Options Granted to Directors and Executive Officers as at 31 December 2005

	Outstanding			Exercisable	
Exercise Price Range	Number of shares	Weighted average life remaining (years)	Weighted average exercise price ($)	Number of shares	Weighted average exercise price ($)
10.94 – 12.23	**107,005**	**3.7**	**11.46**	**107,005**	**11.46**
21.17 – 25.16	**215,449**	**5.3**	**23.38**	**160,983**	**23.17**
25.35 – 31.61	**10,001**	**2.6**	**27.07**	**5,835**	**27.06**
33.51 – 38.86	**268,734**	**7.4**	**37.03**	**37,442**	**36.46**
45.00 – 46.55	**13,509**	**4.8**	**45.71**	**–**	**–**
Total	**614,698**	**5.9**	**27.82**	**311,265**	**20.81**

Employees Stock Option Plan	2005		2004	
31 December	Number of stock options	Weighted average exercise price ($)	Number of stock options	Weighted average exercise price ($)
Outstanding at beginning of year	**1,217,466**	**28.72**	984,639	22.08
Granted	**495,309**	**37.53**	424,240	40.23
Stock dividend granted	**159,708**	**29.65**	120,965	28.26
Exercised	**(350,820)**	**25.65**	(231,393)	19.84
Forfeited / cancelled	**(114,598)**	**34.07**	(80,985)	32.88
Outstanding at end of year	**1,407,065**	**30.00**	1,217,466	28.72
Vested and exercisable at end of year	**708,588**	**24.87**	521,134	21.06

Characteristics of Options Granted to Employees as at 31 December 2005

	Outstanding			Exercisable	
Exercise Price Range	Number of shares	Weighted average life remaining (years)	Weighted average exercise price ($)	Number of shares	Weighted average exercise price ($)
10.94 – 12.23	**115,459**	**4.0**	**11.27**	**115,459**	**11.27**
21.17	**162,139**	**5.5**	**21.17**	**162,139**	**21.17**
22.99 – 24.95	**345,232**	**6.7**	**24.30**	**242,710**	**24.47**
36.57 – 37.73	**784,237**	**8.7**	**37.09**	**188,280**	**36.91**
Total	**1,407,067**	**7.4**	**30.00**	**708,588**	**24.87**

The weighted average fair value of stock options granted in the year ended 31 December 2005 was $5.18 per stock option (2004: $6.80), calculated using the Black-Scholes option-pricing model with the following weighted average assumptions:

Year Ended 31 December	2005	2004
Projected dividend yield	**4.00%**	3.14%
Risk free interest rate	**3.71%**	3.17%
Projected volatility	**19%**	20%
Expected life	**5.0**	5.0

Had compensation cost been determined based on the fair value of the stock option awards at the date of grant, net income and earnings per share would have been reduced to the pro-forma amounts shown below:

Year Ended 31 December	2005	2004
Net income as reported	**109,351**	90,466
Net income – pro-forma	**107,560**	89,122
Earnings per share – as reported (basic)	**4.34**	3.62
Earnings per share – pro-forma (basic)	**4.27**	3.56

NOTE 20: Share Buy-Back Plan

During the year under review, 32,890 shares (2004: 459,232) were purchased and cancelled at a cost of $1.4 million (2004: $19.4 million). During the same period, the Bank's Stock Option Trust bought 285,854 shares at a cost of $12.6 million (2004: nil).

The Bank has the present intention to repurchase over the twelve month period commencing 1 January 2006, up to 2,000,000 million of its ordinary shares of par value $1 each, pursuant to its share repurchase programme authorised by the shareholders on 29 October 1997. This intention is subject to appropriate market conditions and repurchases will only be made in the best interest of the Bank.

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 then the last independent trade.

The BSX is advised monthly of shares repurchased and cancelled by the Bank and shares purchased by the Stock Option Trust.

NOTE 21: Dividend Re-Investment and Common Stock Purchase Plans

The Bank's dividend re-investment and common stock direct purchase plans permit participants to purchase, at fair market value, shares of the Bank's common stock by re-investment of dividends and / or optional cash payments, subject to the terms of each plan.

NOTE 22: Stock Dividend

In August 2005 and August 2004, the Bank distributed a 10% stock dividend to shareholders of record on 5 August 2005 and 5 August 2004 respectively. All prior period per share amounts have been restated to reflect the stock dividend.

NOTE 23: Variable Interest Entities

The effect of FIN 46R was a decrease in the Bank's net assets of approximately $0.6 million for the year ended 31 December 2005 (2004: $0.5 million). The decrease primarily relates to the Bank's venture capital investment subsidiary (Butterfield Vencap Limited). Butterfield Vencap Limited holds investments in private and listed companies where the nature of the investment relationship is such that the Bank, through Butterfield Vencap Limited may absorb a majority of the expected losses of these companies or receive a majority of the residual returns of these companies.

As at 31 December 2005 the total assets of VIEs consolidated in the balance sheet is $17.7 million (2004: $10.7 million).

NOTE 24: Income Taxes

The Bank is not subject to any taxes in Bermuda on either income or capital gains under current Bermuda law. The Bank's income tax expense or benefit for all periods presented relates to income from continuing operations and is attributable to subsidiaries and offices in various other jurisdictions that are subject to the relevant taxes in those jurisdictions.

31 December	2005	2004
Income taxes in consolidated statement of income		
Current	1,358	(422)
Deferred	270	(1,300)
Total tax expense (recovery)	1,628	(1,722)
Deferred income tax asset		
Tax loss carried forward	3,229	8,168
General bad debt allowance	33	39
Pension liability allowance	2,230	1,186
Allowance for compensated absence	14	40
Onerous leases	190	225
Other	495	214
Total asset	6,191	9,872
Deferred income tax liability		
Depreciation	–	2,367
Net unrealised gain on derivatives	–	16
Other	3	–
Total liability	3	2,383
Net deferred income tax asset	6,188	7,489

NOTE 25: Future Accounting Developments

a) Share-based payment

In December 2004, the Financial Accounting Standards Board issued a revised version (FAS 123R) of the previously issued FAS 123 Accounting for Stock-Based Compensation. Under FAS 123R, share-based payments classified as equity, such as the Bank's stock option plan, will be measured and recognised in the statement of income at their fair value. Under the original FAS 123, the Bank chose the option to present such compensation costs not in the consolidated statement of income but instead measured at their fair value as a pro-forma item which is presented in note 19 to the consolidated financial statements for the year ended 31 December 2004, as set out in the Annual Report and in note 4 to these interim financial statements.

Following a further pronouncement in April 2005, FAS 123R will now be effective for all periods beginning after 1 January 2006 and, therefore, effective from the Bank's first quarter in 2006.

b) Pension and post-retirement medical benefits accounting and disclosures

The FASB is expected to issue an exposure draft in March 2006 proposing changes that would require the Bank to recognise a balance sheet asset or liability equal to the full amount of its net surplus or deficit in the pension and other post-retirement benefit plans, with the corresponding income or loss included in other comprehensive income. Management is currently evaluating the effect of adoption which may be material.

BOARD OF DIRECTORS & PRINCIPAL BOARD COMMITTEES

Committees indicated by numbers

2
James A. C. King, JP, Chairman
Chairman, KeyTech Ltd.
Chairman, Argus Insurance Co. Ltd.

1
Robert J. Stewart, JP, Vice Chairman
Chairman, Island Circle Limited, Bermuda
Director, Shell Trust (Bermuda) Limited

2
Arlene Brock
Lawyer / Mediator
Retired from the Board 11 April 2005

2, 4
Brian Duperreault
Chairman, ACE Limited
Director, Tyco International Ltd.

1, 4
Roderick A. Ferguson III, JP
Chairman, Gorham's Ltd.
Chairman, Purvis Ltd.
Deputy Chairman, KeyTech Ltd.

4
A.L. Vincent Ingham, JP
Executive Vice President & Chief Operating Officer, BELCO Holdings Limited
Director, BELCO Holdings Limited

3, 4
Sheila G. Manderson
Chief Executive Officer, KeyTech Ltd.

1, 3
Robert A. Mulderig
Retired Chairman & Chief Executive Officer, Mutual Risk Management Ltd.
Chairman, Woodmont Trust Co. Ltd.

1, 2
Robert Steinhoff,
Retired Partner, KPMG
Director, Argus Insurance Co. Ltd.

3
Alan R. Thompson*
President & Chief Executive Officer,
The Bank of N. T. Butterfield & Son Limited

3, 4
Glenn M. Titterton
Chairman, BF&M Insurance Group
Retired President & Chief Executive Officer, BF&M Insurance Group
Chairman, Insurance Corporation of Barbados Limited

1, 2
Harry Wilken*
President, Jardine Matheson International Services Limited

John R. Wright*
Retired Bank Chief Executive

*Non-Bermudian

Principal Board Committees:
1 Audit & Compliance Committee
2 Risk Policy Committee
3 Corporate Governance Committee
4 Human Resources Committee

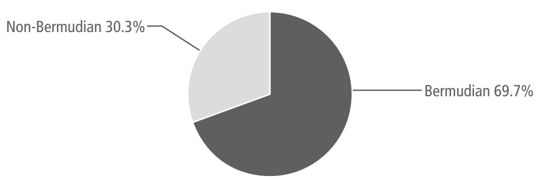
Directors' Code of Practice and Group Code of Conduct

The Directors have adopted a Code of Best Practice based upon recommended principles of corporate governance. In implementing the Code, the Board meets regularly, retains full effective control over the Bank, and monitors executive management. A Group Code of Conduct applies to Directors and employees and imposes the Bank's principles of business, including ethics and conflicts of interest. Copies of the Codes can be accessed on www.butterfieldbank.com/web2000/shareholder_info.

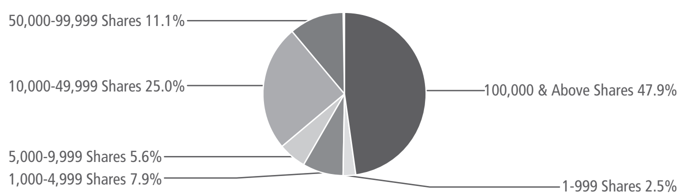
Directors' and Executive Officers' Share Interests and Directors' Service Contracts

Pursuant to Regulation 6.8(3) of section IIA of the Bermuda Stock Exchange Listing Regulations, the total interests of all Directors and Executive Officers of the Bank in the shares of the Bank as at 31 December 2005 were 899,201 shares. With the exception of those participating in the Shareholders' Dividend Reinvestment Plan or the Stock Option Plan, no rights to subscribe for shares in the Bank have been granted to or exercised by any Director or Officer. None of the Directors or Executive Officers had any interest in any debt securities issued by the Bank or its subsidiaries.

There are no service contracts with Directors, except for Alan R. Thompson, President & Chief Executive Officer, whose contract expires on 30 June 2007.



Split Of Share Ownership: Bermudian / Non-Bermudian



Distribution Of Shares By Number Held

Directory

MANAGEMENT

Alan R. Thompson
President & Chief Executive Officer

Graham C. Brooks
Executive Vice President,
International

C. Wendell Emery, MBE, JP
Executive Vice President,
Operations & Information Technology

Richard J. Ferrett
Executive Vice President,
Chief Financial Officer

Bruce Albrecht
Senior Vice President,
Group Head of Asset Management

Mariano R. Browne
Managing Director,
Butterfield Bank (Barbados) Limited

Sheila M. Brown
Senior Vice President,
Investment Services

Andrew R. Collins
Managing Director,
Butterfield Fund Services (Bermuda) Limited

Ian M. Coulman
Managing Director,
Butterfield Asset Management Limited

Donna E. Harvey Maybury
Senior Vice President,
Human Resources

Graham M. Jack
Managing Director,
Butterfield Trust (Bermuda) Limited

Robert V. Lotmore
Managing Director,
Butterfield Bank (Bahamas) Limited

Michael A. McWatt
Senior Vice President,
Credit Risk Management

Conor O'Dea
Managing Director,
Butterfield Bank (Cayman) Limited

Michael O'Mahoney
Senior Vice President,
Treasury

Robert S. Moore
Managing Director,
Butterfield Bank (Guernsey) Limited

Pete D. Ramsdale
Senior Vice President,
Chief Information Officer

Peter J.M. Rodger
Senior Vice President & Group Legal
Adviser, Secretary to the Board

Frank J. Sebestyen, III
Senior Vice President,
Group Head of Fund Services

W. Aaron M. Spencer
Senior Vice President,
Operations

James R. Stewart
Senior Vice President,
Enterprise Risk Management

Fred H. Tesch
Senior Vice President,
Group Internal Audit

Paul A. Turtle
Managing Director,
Butterfield Bank (UK) Limited

Lloyd O. Wiggan
Senior Vice President,
Retail Banking

Bob W. Wilson
Senior Vice President,
Corporate and Private Banking

PRINCIPAL GROUP COMPANIES

This list does not include all companies in the Group. It includes all companies that materially contribute to the profit or loss or assets of the Group.

The Bank of N.T. Butterfield & Son Limited
Bermuda
Holding company, banking, credit and treasury services

Butterfield Asset Management Limited
Bermuda
Investment management and capital market services

Butterfield Fund Services (Bermuda) Limited
Bermuda
Investment and pension fund administration services

Butterfield Trust (Bermuda) Limited
Bermuda
Trust and private banking services

Grosvenor Trust Company Limited
Bermuda
Trust and private banking services

Field Real Estate Holdings Limited
Bermuda
Real estate holding

Butterfield Bank (Bahamas) Limited
The Bahamas
Private banking, treasury, wealth management and fiduciary services, and fund administration services

Butterfield Fund Services (Bahamas) Limited
The Bahamas
Investment and pension fund administration services

Butterfield Bank (Barbados) Limited
Barbados
Banking, credit and treasury services

Butterfield Bank (Cayman) Limited
Cayman Islands
Banking, credit, treasury, wealth management and fiduciary services

Butterfield Fund Services (Cayman) Limited
Cayman Islands
Investment and pension fund administration services

Butterfield Bank (Guernsey) Limited
Guernsey
Private banking, treasury and wealth management services

Butterfield Fund Services (Guernsey) Limited
Guernsey
Investment and pension fund Administration services

Butterfield Trust (Guernsey) Limited
Guernsey
Fiduciary services

Butterfield Bank (UK) Limited
United Kingdom
Private banking, credit, treasury and investment management services

SHAREHOLDER INFORMATION

Dividend Payment
Payment of dividends is quarterly, occurring in November, March, May and August

Exchange Listing
The Bank's shares are listed on The Bermuda Stock Exchange (BSX) and the Cayman Islands Stock Exhange (CSX), located at:

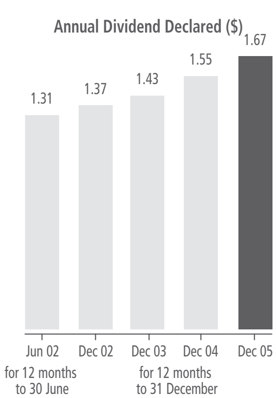
Bermuda Stock Exchange (Primary Listing)
Phase 1 – 3rd Floor, Washington Mall,
Church Street, Hamilton HM 11, Bermuda
Tel: (441) 292-7212 or (441) 292-7213
Fax: (441) 292-7619
www.bsx.com

Cayman Islands (Secondary Listing)
Elizabethan Square, 4th Floor, P.O. Box 2408
GT, Grand Cayman, Cayman Islands
Tel: (345) 945-6060
Fax: (345) 945-6061

Share Dealing Service
Butterfield Securities (Bermuda) Limited
65 Front Street
Hamilton, Bermuda
Tel: (441) 299-3972
Fax: (441) 296-8867

Share Price
Published daily in The Royal Gazette in Bermuda and available on Bloomberg Financial Markets (symbol: NTB BH).
Also available on the BSX web site (www.bsx.com).

Dividend Reinvestment Plan
Details are available from Butterfield Fund Services (Bermuda) Limited.
Certain restrictions apply.



Registrar and Transfer Agent Butterfield Fund Services (Bermuda) Limited
Rosebank Centre
11 Bermudiana Road
Pembroke, Bermuda
Tel: (441) 298-6464
Fax: (441) 295-6759
E-mail: contact@bntb.bm

Head Office The Bank of N. T. Butterfield & Son Limited
65 Front Street
Hamilton, Bermuda
Tel: (441) 295-1111
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Media Relations / Publication Requests Marketing & Communications
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Investor Relations
Chief Financial Officer
Tel: (441) 299-1643
E-mail: richardferrett@bntb.bm

Written Notice of Share Repurchase Programme – BSX Regulation 6.38
The Board of Directors of the Bank announced the intention to repurchase over the 12 month period commencing 1 January 2006, up to 2,000,000 of its ordinary shares of par value $1 each pursuant to its share repurchase programme authorised by shareholders on 29 October, 1997.

As at 31 December, 2005, 2,000,000 shares represented 7.4% of total issued shares of the Bank. This intention is subject to appropriate market conditions and repurchases will only be made in the best interests of the Bank. The Directors consider that share repurchase is an excellent means of enhancing shareholder value while increasing earnings per share.

Shares repurchased and cancelled in the 12 months to 31 December 2005 totalled 32,890 at an average price of $41.46 and aggregate cost of $1,365,448 million.

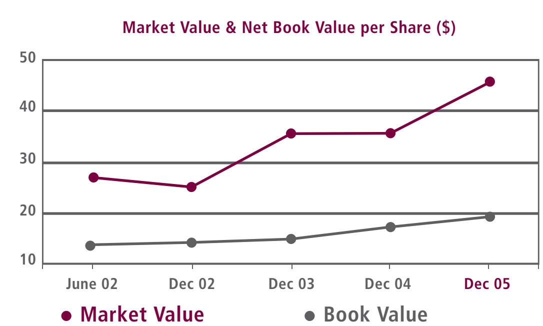
From time to time the Bank's associates, insiders, and insiders' associates as defined in the BSX Regulations may sell shares which may result in being repurchased pursuant to the programme, but under BSX Regulations such trades must not be pre-arranged and all repurchases must be made in the open market.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

The Bank will continue to advise the BSX monthly of shares repurchased and cancelled.

In addition and separate to the above, the Bank's Stock Option Trust may from time to time purchase shares of the Bank through the BSX to satisfy the Bank's obligations with respect to the Stock Option Plan, and such purchases will likewise be advised to the BSX monthly. Shares purchased in this way in the 12 months to 31 December, 2005 totaled 285,854 shares at an average price of $44.10 and aggregate cost of $12,621,318.

Large Shareholders
The following professional nominees at 31 December 2005 were registered holders of 5% or more of the issued share capital: Harcourt & Co. (15.2%), Palmar Limited (5.72%) and Murdoch & Co. (5.14%).

Known beneficial holdings of 5% or more of issued share capital, at that date, were: Bermuda Life Insurance Company Limited (6.83%); Jardine Strategic Holdings Limited (6.57%); and the Bank's Stock Option Trust (5.85%).



Directory

PRINCIPAL BERMUDA OFFICES & SUBSIDIARIES

HEAD OFFICE
The Bank of N.T. Butterfield & Son Limited
President & CEO: Alan R. Thompson

65 Front Street, Hamilton HM 12
P.O. Box HM 195
Hamilton HM AX
Bermuda
Tel: (441) 295-1111
Fax: (441) 292-4365
S.W.I.F.T.: BNTB BM HM
E-mail: contact@bntb.bm
www.butterfieldbank.com

BERMUDA SUBSIDIARIES
Butterfield Asset Management Limited
Managing Director: Ian M. Coulman

65 Front Street,
Hamilton HM 12, Bermuda
Tel: (441) 299-3817
Fax: (441) 292-9947
E-mail: contact@bntb.bm
www.bam.bm

Butterfield Fund Services (Bermuda) Limited
Managing Director: Andrew R. Collins

Rosebank Centre, 11 Bermudiana Road,
Pembroke, Bermuda
Tel: (441) 299-3954
Fax: (441) 295-6759
E-mail: andrewcollins@bntb.bm

Butterfield Trust (Bermuda) Limited
Managing Director: Graham M. Jack

65 Front Street,
Hamilton HM 12, Bermuda
Tel: (441) 299-3980
Fax: (441) 292-1258
E-mail: contact@bntb.bm

PRINCIPAL OVERSEAS OFFICES & SUBSIDIARIES

THE BAHAMAS
Butterfield Bank (Bahamas) Limited
Managing Director: Robert V. Lotmore

Butterfield Fund Services (Bahamas) Limited
Managing Director: Heather Bellot

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P.O. Box N-3242
Nassau, Bahamas
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E-mail: info@butterfieldbank.bs

BARBADOS
Butterfield Bank (Barbados) Limited
Managing Director: Mariano R. Browne

1st Floor, Carlisle House, Hincks Street,
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Tel: (246) 431-4500
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E-mail: contact@butterfieldbank.bb

Butterfield Asset Management (Barbados) Limited
Vice President: Caroline J. Prow

Belleville Corporate Centre, 38 Pine Road,
Bellville, St Michael, Barbados
Tel: (246) 430-1650
Fax: (246) 436-7999
E-mail: carolineprow@butterfield.bb

CAYMAN ISLANDS
Butterfield Bank (Cayman) Limited
Managing Director: Conor O'Dea

Butterfield Fund Services (Cayman) Limited
Managing Director: John Lewis

Butterfield House, 68 Fort Street,
George Town, P.O. Box 705 GT
Grand Cayman, Cayman Islands
Tel: (345) 949-7055
Fax: (345) 949-7004
E-mail: info@butterfieldbank.ky
www.butterfieldbank.ky

GUERNSEY
Butterfield Bank (Guernsey) Limited
Managing Director: Robert S. Moore

Butterfield Trust (Guernsey) Limited
Managing Director: Paul D.H. Hodgson

P.O. Box 25, Regency Court, Glategny
Esplanade, St Peter Port, Guernsey GY1 3AP,
Channel Islands
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Fax: (01481) 714-533
E-mail: info@butterfield.gg
www.butterfieldbank.gg

Butterfield Fund Services (Guernsey) Limited
Managing Director: Patrick A.S. Firth

P.O. Box 211, Regency Court, Glategny
Esplanade, St Peter Port, Guernsey GY1 3AP,
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Tel: (01481) 720-321
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www.butterfieldbank.gg

UNITED KINGDOM
Butterfield Bank (UK) Limited
Managing Director: Paul A. Turtle

99 Gresham Street,
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www.butterfieldprivatebank.co.uk

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