

*Re:2008*



## **MISSION**

Butterfield 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 financial services.

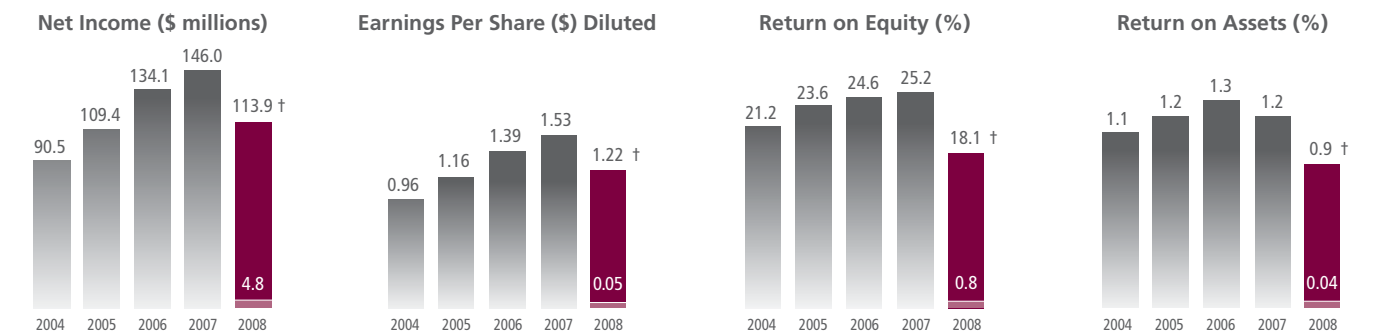
# FINANCIAL & STATISTICAL SUMMARY

(In \$ thousands except per share data)	2008	2007	Year ended 2006	2005	2004
<b>Net income before other gains and losses</b>	<b>113,890</b>	146,331	127,906	108,495	83,863
Other gains (losses)	(109,051)	(336)	6,177	856	6,603
<b>Net income</b>	<b>4,839</b>	145,995	134,083	109,351	90,466
Diluted earnings per share	<b>0.05</b>	1.53	1.39	1.16	0.96
<b>At year end</b>					
Total assets	<b>10,911,844</b>	11,910,920	11,132,802	9,197,566	8,630,383
Cash and deposits with banks	<b>2,221,390</b>	2,517,012	3,151,191	2,849,920	2,396,724
Investments	<b>3,824,079</b>	4,744,989	3,786,793	2,916,399	3,266,400
Loans	<b>4,418,277</b>	4,124,764	3,760,745	3,085,594	2,645,331
Deposits from customers	<b>9,406,175</b>	10,441,579	9,755,659	7,948,966	7,404,855
Deposits from banks	<b>395,094</b>	306,392	287,173	291,143	502,595
Subordinated capital and senior debt	<b>282,296</b>	284,191	280,168	278,679	142,333
Shareholders' equity	<b>518,440</b>	629,330	549,553	495,226	428,030
Net book value per common share	<b>5.64</b>	6.76	5.87	5.36	4.72
Market value per common share	<b>10.45</b>	18.25	18.75	14.12	11.16
Number of common shares (in thousands)*	<b>91,927</b>	84,553	28,375	25,429	22,745
Number of shareholders	<b>4,465</b>	4,201	3,915	3,878	3,778
Number of employees	<b>1,692</b>	1,850	1,730	1,597	1,552
<b>Financial ratios</b>					
Return on shareholders' equity	<b>0.8%</b>	25.2%	24.6%	23.6%	21.2%
Total capital ratio	<b>11.2%</b>	13.0%	13.5%	13.1%	10.7%

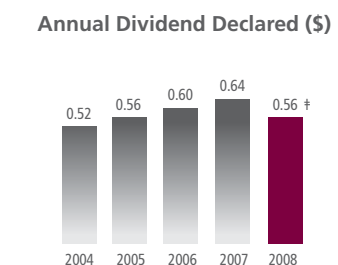
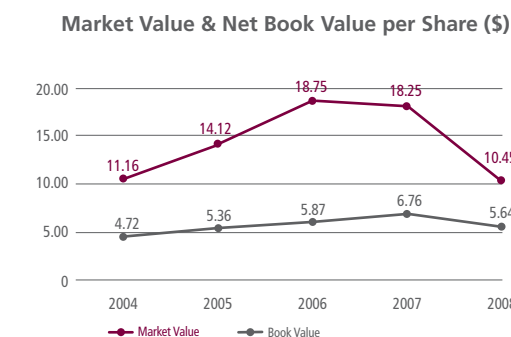
In tables and graphs on this page all prior period per share data, have been restated to reflect the one for ten stock dividends in February 2008, August 2006, 2005, and 2004 and the three for one stock split in August 2007.

All percentages here and in the report that follows are based on actual rather than rounded numbers.  
\* Actual outstanding; excludes common shares held as treasury stock and common shares held by the Bank's Stock Option Trust.

The year  
in *Review*



† = Before gains and losses  
= After gains and losses



† 4¢ payable in shares

*"For over 150 years, Butterfield has been helping individuals, families and businesses protect, grow and optimise their financial well-being."*

## ABOUT BUTTERFIELD

Butterfield is a diversified financial services company operating in nine jurisdictions. We have total assets of \$10.9 billion, client assets under management of \$9.1 billion and over \$54 billion of client assets under administration. We employ 1,692 people around the world. Butterfield is a publicly traded company with a primary share listing on the Bermuda Stock Exchange and a secondary listing on the Cayman Islands Stock Exchange.

For over 150 years, Butterfield has been helping individuals, families and businesses protect, grow and optimise their financial well-being. From our Bermuda roots, we have strategically extended our reach across key local markets and international centres, building a versatile platform of services to meet clients' needs.

From everyday banking to wealth management and highly specialised institutional services, at Butterfield, clients work with some of the most experienced people in the business—approachable, disciplined and proactive professionals who are committed to understanding clients' goals and identifying relevant, pragmatic strategies to help get them there.

We strive to match clients with professionals who seek to understand the things that matter to them; professionals who have the resources and expertise to help them realise their ambitions... on their terms. To develop long-term, collaborative relationships with clients. To identify relevant opportunities and head off issues. To champion clients' interests.

Quality solutions, crafted with care by genuine and experienced professionals. That's the Butterfield way.

## CHAIRMAN'S LETTER TO THE SHAREHOLDERS



2008 was undoubtedly the most challenging year for financial institutions in the latter half of Butterfield's 150 years in operation. The sub-prime crisis and the resulting collapse of the US residential real estate market led to unprecedented strain on the worldwide financial system. Only the swift and massive intervention of governments around the globe restored some semblance of order to the markets.

Although Butterfield achieved a profit in 2008, the Bank's results were disappointing. Net income before gains and losses amounted to \$114 million, which was a satisfactory result in a challenging market. In addition, Butterfield realised a \$115 million gain on the merger of its Fund Services businesses with Fulcrum Group. However, offsetting these positive items were substantial losses incurred in both the Bank's investment portfolio and in its support of the Butterfield Money Market Fund, which reduced net income to \$4.8 million or \$0.05 per diluted share. These losses, which occurred primarily on US residential mortgage backed securities that were very highly rated when purchased, were not large as a percentage of Butterfield's \$3.3 billion investment portfolio but were large in absolute terms. The Bank also wrote off certain previously capitalised investments in technology.

Behind the lower than expected net income figure, however, there is positive news. Butterfield made good progress against its strategic priorities, particularly in improving its information technology infrastructure. These enhancements are expected to result in customer service improvements, as well as improvements in information management and internal controls. 2008's market turmoil resulted in severe strains on many large international banks that relied on the global inter-bank credit markets for funding. As Butterfield is engaged in retail banking in key jurisdictions, it does not rely on inter-bank borrowing to fund its credit businesses. This, along with Butterfield's conservative approach to lending and the high quality of its loan book, served the Bank well. Butterfield is liquid and its capitalisation comfortably met all regulatory requirements at year end. The Bank's tier 1 capital ratio was 7.5% at 31 December 2008, and its total capital ratio was 11.2%.

Challenging times call for greater capital cushions. The economies in which Butterfield operates are all facing challenges and we cannot rule out the possibility of further losses in the investment portfolio. This caused the Board to seek to raise capital and was reinforced by a directive from the Bermuda Monetary Authority requiring all banks in Bermuda to have adequate capital buffers against the possibility

of a pronounced and prolonged economic downturn. Butterfield responded with an offering of \$200 million in non-convertible preference shares, guaranteed by the Government of Bermuda. On a pro forma basis, as at 31 December 2008, this additional capital buffer would have raised Butterfield's tier 1 capital and total capital ratios to 10.6% and 15.1%, respectively. Butterfield is appreciative of the Government's support, which is expected to facilitate the placement of the new preference shares in a global market that is currently unreceptive to bank capital raises. Consistent with the decision to enhance Butterfield's capital, the Board made the difficult decision to reduce the fourth quarter dividend to \$0.08 per share (\$0.04 in cash and \$0.04 in common shares).

Your Board is aware that many shareholders are concerned about the decline in value of Butterfield's common shares over the course of 2008. Enhancing Butterfield's value for shareholders is our principal objective and we continue to have confidence in the ability of Butterfield's experienced management team to lead the Bank through difficult times and generate sustainable value over the long term.

In 2008, we welcomed three new Directors to the Board: Graham Brooks, Butterfield's Executive Vice President, International; Sheila Lines, Chief Executive Officer of Keytech Limited; and Patrick Tannock, Executive Vice President at ACE Bermuda. The perspectives and expertise of Messrs. Brooks and Tannock and Ms. Lines proved invaluable to the Board as we worked to oversee the Bank's operations during a challenging year. Robert Stewart, who served as Vice Chairman, retired in 2008. We thank Mr. Stewart for the valued insight and leadership he provided over his 20 years as a Director of the Bank. Robert Steinhoff, Chairman of the Audit Committee, who has been a member of the Board since 2004, succeeded Mr. Stewart as Vice Chairman. The Board also wishes to express thanks to Mr. Peter Rodger who retired after many years of service as Secretary to the Board.

As Butterfield enters its 151st year of continuous operations, it does so as an organisation that is proud of its past, strengthened by the challenges it has successfully faced and confident in its future. On behalf of the Board of Directors, I thank you for your loyalty, which we hope to repay with enhanced shareholder returns.

Robert A. Mulderig | Chairman of the Board

## PRESIDENT & CHIEF EXECUTIVE OFFICER'S REPORT



2008 was a watershed for financial services; a year that changed the business of banking and the nature of relationships between banks and governments, and banks and their publics. It was a year that brought the interconnectedness of the world's financial and commercial systems into sharp focus, and one in which the bad decisions made by a relative few begat bad fortunes for individuals, industries and economies globally.

For Butterfield, 2008 was one of the most notable years in our history. It was the year in which we celebrated our 150th anniversary and took important steps to revitalise our franchise; one in which we were tested, but one from which we emerged as a strong, focused organisation.

Although we enjoyed a good first quarter in 2008, amid the market turbulence that played out during the balance of the year, we had significant write downs on investments and credit arrangements in subsequent quarters. Specifically, Butterfield had losses and write downs of \$151.8 million on securities in our held-to-maturity investment portfolio and unrealised losses of \$50.2 million related to credit support agreements provided by the Bank to the Butterfield Money Market Fund. In 2008, we also wrote off \$29.2 million on previously capitalised investments in technology, which will facilitate the development of a cost-effective, modern, Group-wide technology solution.

Despite receding economies, investment valuations and interest rates in most of our markets, Butterfield's overall revenues declined only slightly versus 2007, and revenues from our asset management, foreign exchange, trust and custody/administrative services businesses actually increased during the year. Our Barbados, Guernsey and UK businesses generated record profits in a difficult environment. We see this as a validation of our strategy of continued, judicious investment in our areas of core competence—community banking, wealth management and custody/administrative services—and the generally conservative nature of our business practices.

Last year's earnings were buoyed by a significant gain in the third quarter from the merger of Butterfield Fund Services (BFS) with the Fulcrum Group. BFS was a significant contributor to the Group's results and international profile in recent years, but a comprehensive evaluation of the business made it clear that the best way to continue to offer world-class fund administration services to our valued clients was to find a partner company for BFS with complementary strengths. Through our 40% ownership in the new company, Butterfield Fulcrum Group, we are committed to maintaining a strong presence in international fund administration and believe the business will continue to be a source of income for the Bank over the long term.

*"Butterfield continues to rise to the challenges that we are presented with..."*

In May, Butterfield also successfully refinanced outstanding debt with a \$78 million private placement of subordinated lower tier capital notes, a significant accomplishment in difficult capital markets.

Despite the potential distractions of 2008, Butterfield maintained a focus on the goal of becoming a top-quartile performer in key measures of business and operational performance as compared to our international peer banks. To that end, we initiated or continued several major projects during the year that will lead to cost reductions, quality improvements and the realisation of Group synergies. Principal among these were rationalisation and upgrading of our information technology systems, and a project that will see improvements in the levels of marketing coordination among our businesses internationally. We also made important changes in response to market events, taking decisive action to manage residual problematic exposures in our investment portfolios and, more recently, to enhance our already strong capital position.

Butterfield was recognised with several prestigious awards from the international financial press in 2008, including Best Bank in Bermuda from *Euromoney*, and Best Developed Market Bank-Bermuda, Best Local Private Bank in Bermuda and Best Private Bank in the Caribbean from *Global Finance*. Our Card Services team received a Regional Quality Award for excellence in operational achievements from MasterCard® Worldwide, and several of our Europe-based senior staff members were named in *Citywealth's Leaders List 2008*, an annual guide listing the most highly regarded figures in private wealth management.

On behalf of Butterfield's management team, I would like to express my appreciation to all of our employees. It is due to their focus and professionalism that Butterfield continues to rise to the challenges that we are presented with and find success where other companies may falter. I would also like to thank our clients for their loyalty and support. Finally, I thank our Directors for the valued oversight they provided during this most difficult of years.

Alan R. Thompson | President & Chief Executive Officer

# BOARD OF DIRECTORS & PRINCIPAL BOARD COMMITTEES

With the exception of the President & Chief Executive Officer and the Executive Vice President, International, the Board is comprised of independent Directors who are not Butterfield employees.

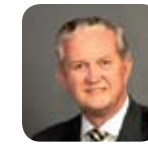
## COMMITTEES INDICATED BY NUMBERS



**4**  
**CHAIRMAN ROBERT A. MULDERIG**  
Retired Chairman & Chief Executive Officer,  
Mutual Risk Management Ltd.  
Chairman, Woodmont Trust Co. Ltd.



**1**  
**SHEILA A. LINES**  
Chief Executive Officer, Keytech Limited



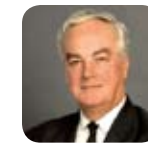
**3, 4**  
**GLENN M. TITTERTON**  
Chairman, BF&M Insurance Group  
Retired President & Chief Executive Officer,  
BF&M Insurance Group  
Retired Chairman, Insurance Corporation  
of Barbados Limited



**1, 4**  
**VICE CHAIRMAN ROBERT STEINHOFF**  
Retired Partner, KPMG  
Director, Argus Insurance Co. Ltd.



**3**  
**SHAUN MORRIS**  
Managing Partner of the Appleby Bermuda law firm



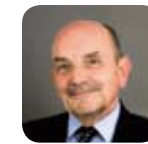
**1, 2**  
**HARRY WILKEN**  
President, Jardine Matheson International  
Services Limited



**GRAHAM C. BROOKS**  
Executive Vice President, International,  
The Bank of N.T. Butterfield & Son Limited



**1, 3**  
**PAULINE RICHARDS**  
Chief Operating Officer,  
Brevan Howard P&C Partners Limited  
Director, Wyndham Worldwide Inc.  
Former Director and Audit Committee Chair,  
Cendant Corporation



**2**  
**JOHN R. WRIGHT**  
Retired Bank Chief Executive



**2, 3**  
**JULIAN W. FRANCIS**  
Former Governor, Central Bank of The Bahamas



**2**  
**PATRICK TANNOCK**  
Executive Vice President, ACE Bermuda



**4**  
**A. L. VINCENT INGHAM, JP**  
President & Chief Executive Officer,  
BELCO Holdings Limited and  
Bermuda Electric Light Company Limited



**ALAN R. THOMPSON**  
President & Chief Executive Officer,  
The Bank of N.T. Butterfield & Son Limited

## PRINCIPAL BOARD COMMITTEES:

### 1. AUDIT & COMPLIANCE COMMITTEE

Oversees Butterfield's financial reports, internal financial controls, internal audit processes and compliance.

### 2. RISK POLICY COMMITTEE

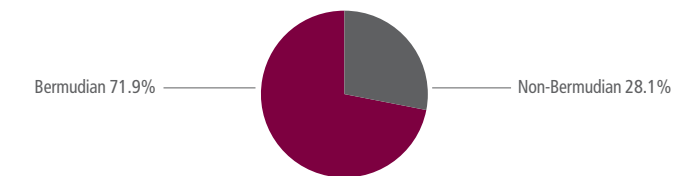
Focuses on credit, market and operational risk.

### 3. CORPORATE GOVERNANCE COMMITTEE

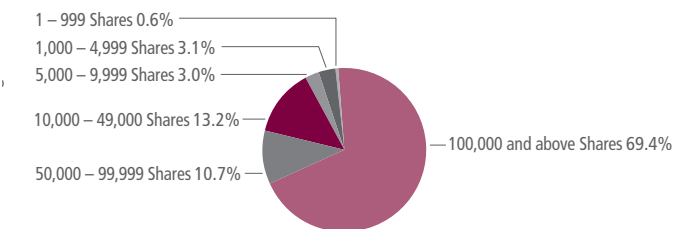
Focuses on Directors' and Board Committee governance, performance and Directors' nominations.

### 4. COMPENSATION & HUMAN RESOURCES COMMITTEE

Focuses on compensation and benefits, employee development and succession.



Share Ownership: Bermudian / Non-Bermudian



Distribution of Shares by Number Held

## 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 Butterfield's principles of business, including ethics and conflicts of interest. Copies of the *Codes* can be accessed on [www.butterfieldgroup.com](http://www.butterfieldgroup.com).

## MANAGEMENT



**ALAN R. THOMPSON**  
President & Chief Executive Officer



**CURTIS BALLANTYNE**  
Senior Vice President  
Chief Credit Officer



**IAN M. COULMAN**  
Managing Director  
Butterfield Asset Management Limited



**ROBERT S. MOORE**  
Managing Director  
Butterfield Bank (Guernsey) Limited



**GRAHAM C. BROOKS**  
Executive Vice President  
International



**MALCOLM BECKER**  
Managing Director  
Butterfield Trust (Malta) Limited



**DONNA E. HARVEY MAYBURY**  
Senior Vice President  
Human Resources



**CONOR O'DEA**  
Managing Director  
Butterfield Bank (Cayman) Limited



**CURTIS L. DICKINSON**  
Executive Vice President  
Wealth Management



**NIC BENTLEY**  
Deputy Chairman  
Butterfield Private Office (HK) Limited



**GRAHAM M. JACK**  
Senior Vice President  
Strategic Development



**JIM PARKER**  
Country Head & Managing Director  
Butterfield Trust (Switzerland) Limited



**WILTON DOLLOFF**  
Executive Vice President  
Chief Operating Officer



**GEORGE BOGUCKI**  
Managing Director  
Butterfield Bank (UK) Limited



**CHARLES LAWRENCE**  
Senior Vice President  
Treasury



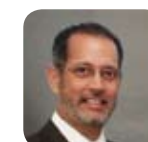
**W. AARON M. SPENCER**  
Senior Vice President  
Group Operations & I.T.



**RICHARD J. FERRETT**  
Executive Vice President  
Chief Financial Officer



**KATIE BOOTH**  
Managing Director  
Butterfield International Private Office Limited



**ROBERT V. LOTMORE**  
Managing Director  
Butterfield Bank (Bahamas) Limited



**FRED H. TESCH**  
Senior Vice President  
Group Internal Audit



**JAMES R. STEWART**  
Executive Vice President  
Chief Risk Officer



**DIANNE M. BREWER**  
Senior Vice President  
Marketing & Corporate Communications



**G. JOHN MARAGLIANO**  
Senior Vice President  
Head of Finance



**LLOYD O. WIGGAN**  
Managing Director  
Butterfield Bank (Barbados) Limited



**BOB W. WILSON**  
Executive Vice President  
Head of Bermuda Banking



**SHEILA M. BROWN**  
Senior Vice President  
Investment Services



**TONYA L. MARSHALL**  
Senior Vice President  
General Counsel  
Secretary to the Board of Directors



**MICHELLE WOLFE**  
Managing Director  
Butterfield Trust (Bermuda) Limited



*Reflecting*  
on 150 years

*"The Butterfield Charitable Foundation distributed \$5 million in Bank shares to 20 registered charities in Bermuda..."*

In 2008, we celebrated our Sesquicentennial; Butterfield's 150th year in financial services. Our origin as a financial institution dates back to the early nineteenth century when our founder, Nathaniel T. Butterfield, recognised a need for foreign exchange and international clearing among clients and suppliers of his mercantile company and undertook to provide these services as an adjunct of his main business. In 1858, N.T. Butterfield abandoned his dry goods business and formally established the Bank in Hamilton, Bermuda.

Over the course of a century and a half in business, Butterfield has had good years and bad, with profits that have risen and receded. Over the long-term, we have enjoyed substantial growth, but on occasion we have had to make difficult decisions to scale back operations, exit businesses or revise strategies in response to changing economic and business realities. In that context, 2008—even with the challenges it presented—can be viewed as a successful year in many respects. Although our net income was disappointing, Butterfield's operating profitability remained strong. We

continued to invest in our employees and future capabilities under a proven growth strategy. Our client base was stable. Our international reach expanded during the year.

To mark the occasion of our 150th anniversary and to celebrate the growth and ongoing success of the Bank, Butterfield held special appreciation events for clients in several of our jurisdictions. Butterfield also erected commemorative branch displays in Bermuda and commissioned a limited edition history of the Bank that was distributed to all employees worldwide.

To acknowledge the support and loyalty of the community in Bermuda (our original location and home to our corporate headquarters,) the Butterfield Charitable Foundation distributed \$5 million in Bank shares to 20 registered charities on the Island for the establishment of endowments. In addition, the Foundation earmarked \$1 million for the funding of capital projects in Bermuda, such as the development of a new pedestrian entrance to the historic town of St. George (a UNESCO World Heritage site).





*Renewing*  
our focus

*"Assessing risks is a normal business activity that is the concern of every employee..."*

Prudent management of Butterfield's risks is integral to our objective of maintaining and enhancing value for shareholders. Butterfield places a priority on risk management in conducting business. In response to the increasing complexity of the market and regulatory environments in which we operate, we continue to build on our significant commitment to risk management programmes and governance.

#### **RISK MANAGEMENT**

The Bank's Enterprise Risk Management (ERM) Division has overall responsibility for assessing credit, market and operational risks associated with the Bank's activities. ERM provides for clear senior management responsibility for all risks with each product having a designated risk owner. Butterfield's Control Framework establishes objectives with regard to the processes and resources that should be brought to bear in the design, implementation and application of internal controls along product lines. Through periodic risk assessments, the Board and executive management are able to obtain a complete and quantifiable view of key product risks and a transparent evaluation of the effectiveness of controls.

With regard to risk management governance, the **Risk Policy Committee of the Board of Directors** has responsibility for establishing and periodically updating the policies that are to be consistently applied across the Group to manage market, liquidity, credit, interest rate, operational, legal reputational, fiduciary and strategic risks. The **Group Risk Committee** of nine Butterfield executives is chaired by the President & Chief Executive Officer and serves in an advisory capacity to the Board Risk Policy Committee. Consistent with our commitment to ERM, the Group Risk Committee promotes an integrated view across all risk disciplines, focusing on all elements of risk at the strategic level. Butterfield's compliance with Basel II regulations (being adopted in Bermuda under the auspices of the Bermuda Monetary Authority) is also a key priority.

The **Asset and Liability Management Committee (ALCO)**, chaired by the Group Chief Financial Officer, monitors Butterfield's balance sheet trends, liquidity, trading positions and off balance sheet exposures, investment portfolios, interest rate and exchange rate exposures and capital position. ALCO has developed specific guidelines for investing in securitised assets and monitors and tests mortgage- and asset-backed securities for potential impairment. Day-to-day interest rate and liquidity risks are managed by the Bank's Treasurer and monitored by the Group Market Risk team within Enterprise Risk Management.

The **Financial Institutions Committee**, chaired by the President & Chief Executive Officer, identifies, assesses, prioritises and manages the Group's risks associated with counterparty exposure to other financial institutions, as well as country-specific exposures.

The **Investment Committee** is chaired by the Group Chief Risk Officer and supports the functions and programmes that identify, assess, prioritise and manage investment risks that are assumed by the Bank and all investment risks assumed by the Butterfield Money Market Fund Limited. It also monitors the Group's compliance with both risk-related regulatory requirements and with its internal risk management policies and standards. The Bank determined in mid-2007 to cease making investments for its own account other than in certificates of deposits issued by well rated financial institutions.

*"Butterfield's longstanding strategy for growth is a focus on developing our core businesses..."*

Chaired by the CEO, the **Credit Committee** provides a forum for ongoing executive review of loan activity, establishing Group credit guidelines and policies and approving selected credit transactions in accordance with Butterfield's business objectives. The Committee reviews large credit exposures, establishes and reviews credit strategy and policy and approves selected credit transactions. Overall responsibility for managing credit policy and process is delegated to the Chief Credit Officer.

Butterfield manages operational risk—the chance of experiencing a favourable or unfavourable outcome (i.e., financial gain or loss) resulting from planned or unplanned changes in business processes and procedures, controls, infrastructures, and our operating environment—through policies, procedures and controls that are developed with a view to the following principles:

- Assessing risks is a normal business activity that is the concern of every employee
- Decisions are based on an assessment of all relevant operational risks
- Risk decisions shall be made at the appropriate level based on delegated authority
- Unnecessary risks shall be avoided

#### **EXPENSE MANAGEMENT**

The Group's expenses increased by \$30.5 million (or 9.6%) in 2008; the increase attributed largely to expenditures on technology and communications and professional and outside services associated with strategic projects. Principal among these was a project to identify a third party provider of information technology services for the Group, which involved a detailed review and analysis of proposals from potential providers and, ultimately, the negotiation of a contract with EDS for the management of Butterfield's information technology infrastructure.

Expense management remains a priority for Butterfield. We believe our investment in the aforementioned strategic projects will assist us in attaining improvements in operating efficiency and will produce savings in the areas of technology development and management, personnel and marketing.

The Group's overall head count was reduced by some 265 positions in January 2009, with the transfer of Fund Services personnel from the Bank to Butterfield Fulcrum Group.

#### **CONCENTRATING ON CORE COMPETENCIES**

Butterfield's longstanding strategy for growth is a focus on developing our core businesses. This involves judicious investment in business areas where we can leverage the expertise of our existing personnel along with the company's experience and reputation. In the main, our focus is on community banking and wealth management, with the latter representing the area of greatest growth potential for the Bank.

With respect to fund administration, long considered to be a core Group business, we made the decision to merge Butterfield Fund Services (BFS) with the Fulcrum Group in August 2008. When we considered the nature and scope of the investment that would be required to maintain sufficient scale and the technology needed to be a competitive full-service provider in the consolidating fund administration industry, we determined that the most expedient way to retain a leadership position was to find a partner with complementary strengths. In the Fulcrum Group, we found a company that had advanced, proprietary technology, a dedicated sales team and offices in locations where BFS did not have a presence. These traits were a natural complement to BFS' international reputation and strong customer relationships.

Far from being an exit strategy, the transaction was a means to enhance Butterfield's position in third-party fund administration internationally. Butterfield retains a 40% ownership stake in the merged company, Butterfield Fulcrum Group. Butterfield also has representatives on the Butterfield Fulcrum Group Board.

Although the revenues enjoyed by fund administrators decreased in the latter half of 2008, due to the declining asset values of funds administered, we are optimistic that the business will rebound as the economy improves and we are confident that Butterfield Fulcrum Group is positioned to take advantage of future growth in the hedge fund industry.

## Reinforcing our capabilities

In 2008, Butterfield made important strategic changes to strengthen our franchise and position the Bank to take advantage of future growth in the financial services industry. Our over-arching goal is to become a Bank that performs in the top 25% internationally when evaluated against key business measures, ranging from governance to information technology to client service, by the end of 2010.

### UPGRADING OUR INFORMATION TECHNOLOGY

In November, Butterfield reached an agreement with leading global technology provider, EDS, an HP company, to supply technology infrastructure management, application development and technical support. We are now in the process of transitioning all of our business applications and international legacy systems to a new, common platform that will be centrally managed. This represents a departure from the decentralised I.T. management structure that has been used in the past and should enable the Bank to realise significant efficiencies by doing away with duplication in the areas of application development, support and licensing.

A major deliverable of the project is the installation of a common core banking platform in multiple jurisdictions. This change will enhance our operating capabilities—giving us a comprehensive view of each client's business with the Bank at the touch of a button—so we are better equipped to offer customised, forward-looking financial solutions. The new system, slated to be rolled out in the Cayman Islands in 2009, followed by Bermuda and the other relevant jurisdictions, will also be the basis of upgraded electronic banking services and improved client reporting.

### STRENGTHENING THE BRAND

Like information technology, marketing was traditionally managed using a decentralised approach, with each office responsible for local advertising and promotional materials. There are opportunities that exist within

the organisation for improved collaboration in the development of marketing materials and the realisation of savings. In 2008, we established a Group-wide marketing council tasked with identifying and capitalising on opportunities to jointly develop materials. Our objective is to develop a stronger Group brand which will help amplify local marketing efforts.

Among the most visible changes in marketing, and a source of expected savings, is the culling of logos used by various divisions and subsidiaries in favour of the updated Butterfield logo (that appears on the cover of this Report,) which will be the new identity used by all of our businesses internationally.

### ENHANCING OUR SERVICES

Across our businesses, Butterfield made targeted improvements to our services during 2008 that were designed to make things more convenient for our clients. Highlights are provided below.

- In Bermuda wealth management, we opened a new investment centre, which serves as a convenient, one-stop shop for clients seeking investment advice, assistance with structuring their portfolios and execution of investment transactions.
- In corporate banking, we created the new position of Captive Insurance Relationship Manager to better meet the specialised needs of valued clients in the Captive Insurance industry.
- We introduced the Super Saver savings account in Barbados, based on a similar, highly successful product offered in Bermuda.

- In our Cayman Islands community banking business, we introduced Saturday banking and relocated our George Town branch to new premises, adding four new ATMs to help shorten queues. We also introduced the Blue Visa Debit Card for business clients.
- In Guernsey banking, we launched a new current account mortgage product, a new packaged property holding structure with the provision of lending facilities, and a new Wealth Management Account that combines banking, lending, custody and investment management services.
- A new Butterfield Trust office officially opened for business in Geneva, Switzerland in January.
- In the UK, we expanded banking services to include children and grandchildren of private clients.
- Bentley Reid offices in Malta and Hong Kong were integrated into the Bank and adopted the Butterfield name and logo.

As we continue to enhance our systems and the levels of collaboration among product experts across Butterfield Group, we will continue to introduce new products and services and improve existing offerings. These actions will help us ensure that we are constantly meeting the needs of our clients and working toward being a top quartile performer among our international peers in all key business measures.



*Reaffirming* our  
commitment to our communities

*"Butterfield employees donated  
their personal time and  
expertise to local causes..."*

As a socially responsible company, Butterfield believes that our role is to do more than offer financial services. At the corporate and employee levels, we pride ourselves on providing support to causes that are encouraging progress and enriching lives in the communities we call home. In addition to the endowment programme and capital campaign developed by the Butterfield Charitable Foundation as part of our 150th anniversary celebrations, Butterfield provided sponsorship and support to a number of events and not-for-profit organisations in 2008.

#### **YOUTH AND EDUCATION**

Across the Group, we awarded four scholarships and seven educational awards/bursaries during 2008. In Guernsey, Butterfield provided support for music programmes for local youth, and our Swiss offices sponsored a charity concert benefitting students in developing countries. In The Bahamas, we continued our support of the Ranfurly Home for Children, and in the Cayman Islands we sponsored the Young Caymanian Leadership Awards, a platform for young leaders to excel and be recognised for their contributions to society.

#### **HEALTH AND WELLNESS**

In Bermuda and Guernsey, we made significant donations to nursing and residential care homes to make necessary structural improvements to enhance the quality of life of the residents. In Malta, we donated to Park of Friendship (Ir-Razzett tal-Hbiberija), an institution that supports improved access for disabled persons. Butterfield's largest annual fundraiser in the Cayman Islands, the 5K Irish Jog, provides all proceeds to the Cayman Islands Cancer Society. In Hong Kong, we support Project Orbis, a flying eye hospital that brings highly-skilled surgeons to developing countries to provide restorative and preventative eye surgeries.

#### **ARTS AND CULTURE**

Butterfield arranged an exclusive showing of a rare Rembrandt painting, *Portrait of a Bearded Man in a Red Doublet* (1633), at the Bermuda National Gallery. We were also a sponsor of the Cayman Arts Festival, where we presented the Garden Opera and hosted master classes for students. We were, again, a proud sponsor of the annual Barbados Jazz Festival.

In addition, many Butterfield employees donated their personal time and expertise to local causes during 2008. We thank them for helping brighten the lives of our friends and neighbours, particularly during difficult economic times.



Results

## MANAGEMENT'S DISCUSSION & ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION.<sup>1</sup>

Results of operations for the 12-month period ended 31 December 2008 compared with the 12-month period ended 31 December 2007.

Butterfield Group's<sup>2</sup> net income before gains and losses for 2008, was \$113.9 million, down 22.0% from \$146.3 million reported for the same period a year ago. However, net income after gains and losses reduced to \$4.8 million as a result of the following:

- A gain on sale of subsidiaries and affiliates of \$115.5 million was recorded, reflecting the sale and merger of our Fund Services businesses with those of the Fulcrum Group to form the new company Butterfield Fulcrum Group in September 2008. Butterfield received \$133.0 million in cash proceeds on the transaction and a 40% ownership interest in the merged entity, which has a carrying value of \$6.0 million.
- A \$5.2 million goodwill impairment charge was taken in respect of Butterfield's investment in its Barbados banking subsidiary. Whilst profitable, earnings have proved to be lower than originally forecast.
- A \$6.4 million unrealised loss on trading securities was recorded, which principally reflects changes in the carrying value of 'seed money' invested in Butterfield Mutual Funds, such as the Canadian Systematic Equity Fund, the Select Alternative Fund and the Select Investment Fund, reflecting negative performances of those funds in the light of world market conditions.

- A \$151.8 million loss was recorded on the Bank's held to maturity (HTM) investment portfolio. This reflected a \$25 million write down in respect of holdings of Icelandic bank senior securities, a \$7.6 million write down of a \$10 million senior security issued by Washington Mutual Bank, and \$119.2 million of write downs of asset-backed securities relating to the US residential mortgage-backed market. The asset-backed securities were AAA when purchased, but have suffered other-than-temporary impairment and have therefore been written down to their fair value. With the exception of one security with a principal value of \$23 million, which has defaulted with no expected recovery value, these asset-backed securities remain current as to payments of principal and interest. However, our analysis leads us to believe that they will not at some stage be able to meet their contractual commitments.
- In addition, net other losses of \$61.2 million were recorded. This was principally made up of unrealised losses of \$50.2 million stemming from two credit support agreements provided by the Bank to the Butterfield Money Market Fund Limited (BMMFL), in order for it to maintain its AAAM rating, and a write down of \$29.2 million on

previously capitalised investments in technology, offset by realised and unrealised gains of \$12.9 million and \$8.7 million respectively from investments in two credit card companies.

<sup>1</sup>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 44, and the notes to those financial statements, which begin on page 48. Certain statements in this discussion and analysis may be deemed to include 'forward-looking statements' and are based on management's current expectations and are subject to uncertainty and changes in circumstances. Forward looking statements are not historical facts but instead represent only management's belief regarding future events, many of which by their nature are inherently uncertain and outside of management's control. Actual results may differ materially from those included in these statements due to a variety of factors, including worldwide economic conditions, success in business retention and obtaining new business and other factors. These statements and notes have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP).

*"Solid growth was seen in revenues from asset management, customer-driven foreign exchange, trust, and custody and other administration services."*

Total revenue, before gains and losses, was \$464.4 million, down from \$470.3 million in 2007. This reflects reduced revenues from investment and pension fund administration following the sale of the Fund Services companies, which has resulted in a 3.1% decline in non interest income to \$212.9 million. Solid growth was seen in revenues from asset management, customer-driven foreign exchange, trust, and custody and other administration services. Net interest income was a record, at \$254.5 million before credit related provisions, up 0.7% year on year. The net interest margin was resilient despite declining interest rates at 2.16% versus 2.18% a year ago, while average interest earning assets were up \$120.8 million to \$11.6 billion.

The Group's balance sheet remains liquid with a loan to customer deposits ratio of 47.0%. Customer deposits, at \$9.4 billion, decreased year on year from \$10.4 billion primarily due the impact of foreign exchange translation on our Guernsey and United Kingdom balances due to the significant strengthening of the US dollar against the UK Pound, from \$1.99 at year-end 2007 to \$1.45. When excluding the impact of foreign exchange translation movements, customer deposits were in line with the prior year.

The Bank maintains a HTM investment portfolio that is designed to be settled on the contractual maturities of the individual securities and monitors its liquidity requirements to ensure it has the ability and intent to hold designated HTM securities to their stated maturity dates. The portfolio was designed to be well diversified investing in highly rated securities. Within this portfolio the Bank has direct and indirect exposures to the US residential mortgage-backed securities market, representing 7.7% of the investment portfolio and 9.2% of the HTM portfolio, compared to 11.5% and 14.5% respectively a year ago. The total mark-to-market discount on remaining US residential mortgage-backed securities was

\$161.7 million compared to their amortised cost (carrying) value of \$293.5 million. Continued instability in the markets for US mortgage-backed and asset-backed securities has adversely affected the liquidity of these markets and thereby made it difficult to obtain market quotations on many of these securities, thereby requiring significant management judgment to determine appropriate fair values. The underlying cash flows of the Bank's holdings of US residential mortgaged-backed securities continue to be in accordance with contractual terms. Our ongoing analysis of the factors used in determining other than temporary impairment, together with the Bank's ability and intent to hold these securities through to contractual maturities, leads to the conclusion that investments that currently have a fair value less than the current carrying value are not other than temporarily impaired.

The loan portfolio increased by 7.1% in 2008, or \$294 million, to \$4.4 billion and now represents 40.5% of assets. Non-performing loans totalled \$36.5 million at year-end 2008, representing 0.8% of total loans, compared to 0.9% a year ago reflecting the Bank's quality underwriting standards. As at 31 December 2008, the general provision for credit losses of \$24.9 million was equivalent to 0.6% of total loans. In addition, there is a specific provision of \$3.5 million held for possible shortfalls in the security for non-performing loans. In total, therefore, the allowance for credit losses is \$28.4 million, or 0.6% of the loan portfolio. Delinquency and charge-off ratios continued to be below industry average.

#### SHAREHOLDER VALUE

Butterfield's Board of Directors approved a fourth quarter dividend of \$0.08 per share, comprised of \$0.04 in cash and \$0.04 in common

shares. This brings the twelve-month dividend to \$0.56 per share, down from \$0.64 per share in 2007, reflecting the reduced level of profitability. The dividend paid to shareholders in 2008 was \$57.7 million, up 6.2% on the previous year and represents a 50.7% payout on net income before gains and losses. On 12 February 2008, the Board approved a one-for-ten bonus share issue, which equated to a 10% stock dividend which was payable on 12 March 2008 to shareholders of record on 20 February 2008. The movement in shareholder value for the year, defined as the change in share price plus dividends reinvested, was a decline of 34.3%, compared to an increase of 0.1% the previous year, reflecting a fall in the Bank's share price from \$18.25 at year-end 2007 to \$10.45 at 31 December 2008, offset by dividends reinvested. By contrast, and including dividends reinvested, the FTSE All-Share Bank share index was down 53.2%.

#### SHARE PURCHASE ACTIVITY

The loan to the Stock Option Trust of \$34.9 million is in respect of potential obligations under the Bank's Stock Option Plan and is deducted from shareholders' equity as treasury stock. The decrease in the loan, from \$41.6 million the previous year, reflects \$6.7 million repayments from cash received on the exercise of stock options by employees and the effect of other share-based payments.

Shares repurchased and held as treasury shares totalled 2,562,997 shares for an aggregate cost of \$38.3 million. There were no shares repurchased and cancelled under the Share Buy-back Plan during the year and there were no shares purchased by the Bank's Stock Option Trust or by the Bank's Charitable Foundation during the same period.

#### PERFORMANCE INDICATORS

The Group's overall strength and performance are indicated by certain key measures. Return on shareholders' equity was 0.8% for the period, down from 25.2% in 2007, while diluted earnings per share were \$0.05 compared with \$1.53 last year. However, when excluding other gains and losses, return on equity was 18.1% and diluted earnings per share was \$1.22, reflecting solid core earnings in a very challenging economic environment.

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 other gains and losses) saw a year on year increase from 65.7% to 72.8% in 2008, reflecting the Group's continued investment in technology projects.

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

## JURISDICTION OVERVIEWS



BUTTERFIELD HEAD OFFICE,  
HAMILTON , BERMUDA

### BERMUDA

Total revenue increased year on year by \$7.3 million, or 3.0%, to \$253.4 million due in part to good growth in net interest income, up 9.6% to \$133.4 million, offset by a \$4.3 million, or 3.5%, decline in non-interest income. Net income before gains and losses, at \$47.9 million, was down from \$67.3 million a year ago, reflecting both the sale of the Fund Services business and increased investment in infrastructure related projects and represents 42.1% of the Group net income before gains and losses in 2008, compared to 46.0% in 2007. Total assets for community banking, at \$5.4 billion, were in line with a year earlier. Revenue from wealth management & fiduciary services, excluding \$16.0 million revenue from investment and pension fund administration, was \$56.7 million, up 2.2% from prior year reflecting strong earnings from the trust and custody businesses. Assets under management were \$6.8 billion, down from \$8.9 billion a year earlier, reflecting declines in asset values, whilst assets under administration in respect of trust and custody were \$8 billion and \$19 billion respectively, compared to \$8 billion and \$23 billion a year earlier. Butterfield Fund Services (Bermuda) Limited was part of the sale of our Fund Services businesses to, and merger with, the Fulcrum Group, to form Butterfield Fulcrum Group, in September 2008. The real estate operating segment, which represents property related costs in Bermuda, recorded a net expense of \$9.5 million in 2008, up \$0.4 million over 2007.

(\$ millions; noted percentage changes reflect year on year variances)

NET INCOME*:	47.9	(▽)	28.8%
REVENUE*:	253.4	(△)	3.0%
CUSTOMER DEPOSITS:	3,701	(▽)	4.0%
LOANS:	2,779	(△)	9.5%
TOTAL ASSETS**:	5,468	(▽)	1.6%
ASSETS UNDER ADMINISTRATION**:	26,675	(▽)	12.9%
ASSETS UNDER MANAGEMENT:	6,757	(▽)	24.0%

\*Before central cost allocations and gains and losses

\*\*Year on year variance excludes fund administration

MAJOR BUSINESS LINES: Community Banking, Private Banking, Asset Management, Personal Trust, Corporate Trust, Custody

NUMBER OF EMPLOYEES: 803



MONTAGUE STERLING CENTRE,  
NASSAU, BAHAMAS

### THE BAHAMAS

Our Bahamas businesses fared well given the difficult climate experienced in 2008. Good growth was seen in both the Fiduciary and Credit Services areas. One of the most notable successes in 2008 was the growth of the loan portfolio by 73.0% year over year, mainly through the International Mortgage offering. Ultra high net worth clients also took advantage of our expertise with The Bahamas Private Trust Company. Butterfield Fund Services (Bahamas) Limited was part of the sale of our Fund Services businesses to, and merger with, the Fulcrum Group, to form Butterfield Fulcrum Group, in September 2008.

(\$ millions; noted percentage changes reflect year on year variances)

NET INCOME*:	2.4	(▽)	23.2%
REVENUE*:	11.1	(▽)	7.6%
CUSTOMER DEPOSITS:	117	(▽)	24.5%
LOANS:	71	(△)	73.0%
TOTAL ASSETS:	155	(▽)	14.5%
ASSETS UNDER ADMINISTRATION**:	2,349	(▽)	26.2%

\*Before central cost allocations and gains and losses

\*\*Year on year variance excludes fund administration

MAJOR BUSINESS LINES: Private Banking, Personal Trust, Corporate Trust

NUMBER OF EMPLOYEES: 62



CARLISLE HOUSE,  
BRIDGETOWN, BARBADOS

## BARBADOS

Our primary goal continues to be increasing market share in the highly competitive Barbados Retail Banking sector. To this end, we introduced the Super Saver savings product during the year and are currently refining our premium banking offering and comprehensive 'professionals' package which will be available for the second quarter 2009 opening of our south coast Banking Centre. Loan growth continued to be impressive, registering an increase of 24.2% over 2007, which was significantly higher than the growth rate of the Barbados banking sector as a whole.

(\$ millions; noted percentage changes reflect year on year variances)

<b>NET INCOME*:</b>	1.5	(Δ 2,453.2%)
<b>REVENUE*:</b>	13.0	(Δ 8.9%)
<b>CUSTOMER DEPOSITS:</b>	232	(Δ 2.4%)
<b>LOANS:</b>	183	(Δ 24.2%)
<b>TOTAL ASSETS:</b>	265	(▽ 4.6%)

\*Before central cost allocations and gains and losses

**MAJOR BUSINESS LINES:** Community Banking

**NUMBER OF EMPLOYEES:** 142



BUTTERFIELD PLACE,  
GEORGE TOWN, GRAND CAYMAN

## CAYMAN ISLANDS

Our ongoing fee based businesses in the Cayman Islands experienced moderate growth in revenues of 9.1% in 2008. The commercial loan portfolio saw significant growth through our strategic regional focus, driving loan growth by 35.3% to \$484 million in 2008. Interest based businesses experienced a significant reduction in margins earned following numerous successive declines in interest rate benchmarks set in international markets during the course of the year, ending at historic lows. Net interest income before credit provisions declined 20.5% to \$49.6 million while non-interest income totalled \$47.2 million. Total revenue before gains and losses was down 16.1% to \$96.2 million. Net income before central cost allocations and gains and losses was \$ 34.3 million, down 39.5%.

Customer deposits rose 27.0% in 2008, with average customer deposit balances rising 6.5% in the year. Total assets rose 22.0% to \$ 3.3 billion. Assets under management were up 6.2% on the year while assets under administration from wealth management businesses, excluding fund administration, declined 6.3%, reflecting continued growth in client relationships offset by declines in financial asset valuations. Butterfield Fund Services (Cayman) Limited was part of the sale of our Fund Services businesses to, and merger with, the Fulcrum Group to form Butterfield Fulcrum Group in September 2008.

(\$ millions; noted percentage changes reflect year on year variances)

<b>NET INCOME*:</b>	34.3	(▽ 39.5%)
<b>REVENUE*:</b>	96.2	(▽ 16.1%)
<b>CUSTOMER DEPOSITS:</b>	2,994	(Δ 27.0%)
<b>LOANS:</b>	484	(Δ 35.3%)
<b>TOTAL ASSETS:</b>	3,329	(Δ 22.0%)
<b>ASSETS UNDER ADMINISTRATION**:</b>	5,384	(▽ 6.3%)
<b>ASSETS UNDER MANAGEMENT:</b>	1,266	(Δ 6.2%)

\*Before central cost allocations and gains and losses

\*\*Year on year variance excludes fund administration

**MAJOR BUSINESS LINES:** Community Banking, Private Banking, Asset Management, Personal Trust, Corporate Trust

**NUMBER OF EMPLOYEES:** 332





REGENCY COURT,  
ST PETER PORT, GUERNSEY

## GUERNSEY

The Guernsey businesses again delivered strong growth with record net income of £10.4 million (\$19.2 million). This was delivered against a very difficult economic backdrop and resulted in broadly flat revenues after accounting for a circa 25% adverse movement in Sterling to Dollar exchange rates. The loan portfolio grew by £50 million year on year as we continued to deepen our relationship with clients. Custodian and investment services also performed well. Butterfield Fund Services (Guernsey) Limited was part of the sale of our Fund Services businesses to, and merger with, the Fulcrum Group to form Butterfield Fulcrum Group in September 2008.

*(noted percentage changes reflect year on year variances)*

	£ millions (functional currency)		\$ millions	
NET INCOME*:	10.4 (Δ 28.4%)		19.2 (Δ 18.5%)	
REVENUE*:	32.1 (▽ 0.3%)		59.2 (▽ 8.4%)	
CUSTOMER DEPOSITS:	883 (▽ 16.8%)		1,288 (▽ 38.8%)	
LOANS:	284 (Δ 20.9%)		415 (▽ 10.9%)	
TOTAL ASSETS:	993 (▽ 16.8%)		1,449 (▽ 38.8%)	
ASSETS UNDER ADMINISTRATION**:	11,730 (▽ 8.3%)		17,117 (▽ 32.6%)	
ASSETS UNDER MANAGEMENT:	437 (▽ 4.6%)		638 (▽ 29.9%)	

\*Before central cost allocations and gains and losses

\*\*Year on year variance excludes fund administration

**MAJOR BUSINESS LINES:** Private Banking, Asset Management, Personal Trust, Corporate Trust, Custody and Custodian Trustee Services, Administered Banking

**NUMBER OF EMPLOYEES:** 191



DIAMOND EXCHANGE BUILDING,  
HONG KONG

## HONG KONG

Our Hong Kong businesses achieved net income of \$1.7 million on revenues of \$3.9 million. The Bentley Reid group of businesses in Hong Kong, acquired in late 2007, was successfully rebranded with the Butterfield name.

*(\$ millions)*

**NET INCOME\*:** \_\_\_\_\_ 1.7

**REVENUE:** \_\_\_\_\_ 3.9

**ASSETS UNDER ADMINISTRATION:** \_\_\_\_\_ 34

*\*Before central cost allocations*

**MAJOR BUSINESS LINES:** Private Wealth Management, Asset Management, Personal Trust

**NUMBER OF EMPLOYEES:** 10



PORTOMASO TOWER,  
ST JULIANS, MALTA

## MALTA

In its first full year of operation as part of the Butterfield Group, Butterfield Trust (Malta) Limited (formerly Bentley Trust Limited) achieved net income of \$0.3 million on revenues of \$1.7 million.

(\$ millions)

NET INCOME\*: \_\_\_\_\_ 0.3

REVENUE: \_\_\_\_\_ 1.7

ASSETS UNDER ADMINISTRATION: \_\_\_\_\_ 713

\*Before central cost allocations

MAJOR BUSINESS LINES: Personal Trust, Company Administration

NUMBER OF EMPLOYEES: 15



BOULEVARD DES TRANCHÉES 16,  
GENEVA, SWITZERLAND

## SWITZERLAND

Established in 2006 and 2007 respectively, our Swiss asset management and trust businesses continue to build our wealth management capabilities, offering a highly specialised, expert service in private wealth structures for both Swiss and international clients. An operating loss of \$3.3 million was recorded on revenues of \$0.3 million reflecting the business development phase of these operations.

(\$ millions; noted percentage changes reflect year on year variances)

NET INCOME\*: \_\_\_\_\_ -3.3 (▽ 204.6%)

REVENUE: \_\_\_\_\_ 0.3 (△ 33.5%)

ASSETS UNDER ADMINISTRATION: \_\_\_\_\_ 25.0 N/A

ASSETS UNDER MANAGEMENT: \_\_\_\_\_ 18.0 (▽ 76.5%)

\*Before central cost allocations

MAJOR BUSINESS LINES: Trust and Company Services, Asset Management

NUMBER OF EMPLOYEES: 8



99 GRESHAM STREET,  
LONDON, UK

## UNITED KINGDOM

Butterfield Bank (UK) Limited, trading as Butterfield Private Bank, offers private banking services to high net worth individuals, their families and business interests from offices in the City of London.

Despite the latter part of 2008 witnessing an unprecedented banking environment, our UK businesses continued to make significant progress, with record net income of £5.5 million (\$10.1 million), up 266.7% on 2007. Total revenues were up 31.7% to £21.2 million, reflecting strong growth in net interest income and revenues from banking and client-driven foreign exchange.

The year saw good growth in both the loan portfolio and assets under administration, up 13.3% and 3.9% respectively, whilst assets under management declined by 21.7%, reflecting economic conditions in global equity markets. The Bentley Reid group of businesses in the UK, acquired in late 2007, was successfully integrated and rebranded with the Butterfield name, which has helped to enhance our client value proposition.

*(noted percentage changes reflect year on year variances)*

	£ millions (functional currency)		\$ millions	
NET INCOME*:	5.5 (Δ 266.7%)		10.1 (Δ 225.8%)	
REVENUE*:	21.2 (Δ 31.7%)		39.1 (Δ 20.7%)	
CUSTOMER DEPOSITS:	737 (▽ 16.0%)		1,075 (▽ 38.3%)	
LOANS:	350 (Δ 13.3%)		510 (▽ 16.6%)	
TOTAL ASSETS:	906 (▽ 10.0%)		1,322 (▽ 33.9%)	
ASSETS UNDER ADMINISTRATION**:	848 (Δ 3.9%)		1,237 (▽ 23.6%)	
ASSETS UNDER MANAGEMENT:	285 (▽ 21.7%)		416 (▽ 42.4%)	

\*Before central cost allocations and gains and losses

\*\*Excluding fund administration

**MAJOR BUSINESS LINES:** Private Banking and Wealth Management, Asset Management, Personal Trust, Treasury Services

**NUMBER OF EMPLOYEES:** 129

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# FINANCIAL OVERVIEW

## INCOME

Total revenue before gains and losses for the Group after provisions was \$464.4 million for the year ended 31 December 2008, down \$5.9 million, or 1.3%, from \$470.3 million for the same period a year ago. Net interest income before provisions for credit losses increased by 0.7% to \$254.5 million. The increase reflects growth in average interest earning assets, up 1.0% to \$11.6 billion, offset by a marginal decline in the net interest margin by 0.02% to 2.16% as a result of the declining global interest rate environment.

We continue to be appropriately reserved with total provisions of \$28.4 million. Non-performing loans totalled \$36.5 million as at 31 December 2008, in line with that of a year ago. They represent 0.8% of the total loan portfolio, compared to 0.9% a year ago. Provisions in respect of credit losses charged to income were \$3.0 million, compared to \$2.0 million last year, while charge-offs for the year were \$4.0 million. Total provisions were \$28.4 million, up from \$26.9 million a year ago, and represent a coverage ratio of 72.9% of non-accrual loans.

Non-interest income, excluding revenues from investment and pension fund administration, grew by 4.1% to \$177.4 million, reflecting business growth, notably from customer-driven foreign exchange (+17.5%), asset management (+8.0%), custody and other administration services (+4.8%) and trust (+2.6%). Revenues from investment and pension fund administration fell from \$49.3 million in 2007 to \$35.6 million, due to the sale of the fund services businesses.

Gains and losses totalled a net loss of \$109.1 million. This reflects a \$115.5 million gain on sale of our fund services subsidiaries, offset by a goodwill impairment charge of \$5.2 million in respect of our Barbados operation, unrealised losses of \$6.4 million on trading securities, principally 'seed money' investments in various Butterfield mutual funds, realised and unrealised losses of \$151.8 million on HTM investments and other losses of \$61.2 million, including an unrealised loss of \$50.2 million from two credit derivative transactions entered into with the BMMFL, a write down of \$29.2 million on previously capitalised investments in technology, offset by realised and unrealised gains of \$12.9 million and \$8.7 million respectively from investments in two credit card companies.

### Changes in Net Interest Income

(In \$ thousands)

For the year ended 31 December	2008			2007		
	Average balance	Interest	Rate	Average balance	Interest	Rate
<b>Assets</b>						
Cash and deposits with banks	2,563,071	80,519	3.14%	3,005,511	124,608	4.15%
Investments	4,767,027	193,006	4.05%	4,569,566	253,831	5.55%
Loans, after provision for credit losses	4,288,159	261,525	6.10%	3,922,337	282,712	7.21%
Interest earning assets	11,618,257	535,050	4.61%	11,497,414	661,151	5.75%
Other assets	495,428	-	-	473,076	-	-
<b>Total assets</b>	<b>12,113,685</b>	<b>535,050</b>	<b>4.42%</b>	<b>11,970,490</b>	<b>661,151</b>	<b>5.52%</b>
<b>Liabilities</b>						
Deposits	9,768,780	269,668	2.76%	9,731,178	395,681	4.07%
Subordinated capital	284,859	13,946	4.90%	281,750	14,853	5.27%
Interest bearing liabilities	10,053,639	283,614	2.82%	10,012,928	410,534	4.10%
Non-interest bearing current accounts	1,145,869	-	-	1,114,722	-	-
Other liabilities	285,289	-	-	262,960	-	-
<b>Total liabilities</b>	<b>11,484,797</b>	<b>283,614</b>	<b>2.47%</b>	<b>11,390,610</b>	<b>410,534</b>	<b>3.60%</b>
<b>Shareholders' equity</b>	<b>628,888</b>			<b>579,880</b>		
<b>Total liabilities and shareholders' equity</b>	<b>12,113,685</b>			<b>11,970,490</b>		
<b>Spread, after provision for credit losses</b>			<b>1.79%</b>			1.65%
<b>Net interest margin, after provision for credit losses</b>			<b>2.16%</b>			2.18%

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

## EXPENSES

The efficiency ratio was 72.8%, compared to 65.7% in 2007, reflecting that growth in the Group's operating expenses before amortisation of intangibles increased by 9.7%, whilst the revenues before credit provisions and gains and losses decreased by 1.0%.

The increase in the operating expenses primarily reflected significant increases in costs relating to professional and outside services, up 54.8% to \$34.5 million, and technology and communications, up 43.2% to \$41.1 million, due to a number of technology, risk management and client services initiatives.

As at 31 December 2008 there were 803 employees in Bermuda, down from 843 a year ago, reflecting the sale and merger of the Bermuda based Fund Services business. Overseas, the total headcount decreased by 118 to 889, again reflecting the sale and merger of the fund services businesses.

## BALANCE SHEET

Total assets decreased by 8.4% to \$10.9 billion, down from \$11.9 billion a year ago. This decrease reflects the significant strengthening of the US dollar against the UK Pound and its impact on the translation of the assets of our Guernsey and United Kingdom businesses. Total customer deposits were \$9.4 billion, down year on year by \$1.0 billion, or 9.9%, from \$10.4 billion, however the decrease was primarily the result of the foreign exchange translation movement. Total loans were up \$0.3 billion to \$4.4 billion. The ratios of loans to customer deposits and loans to total assets were 47.0% and 40.5% respectively.

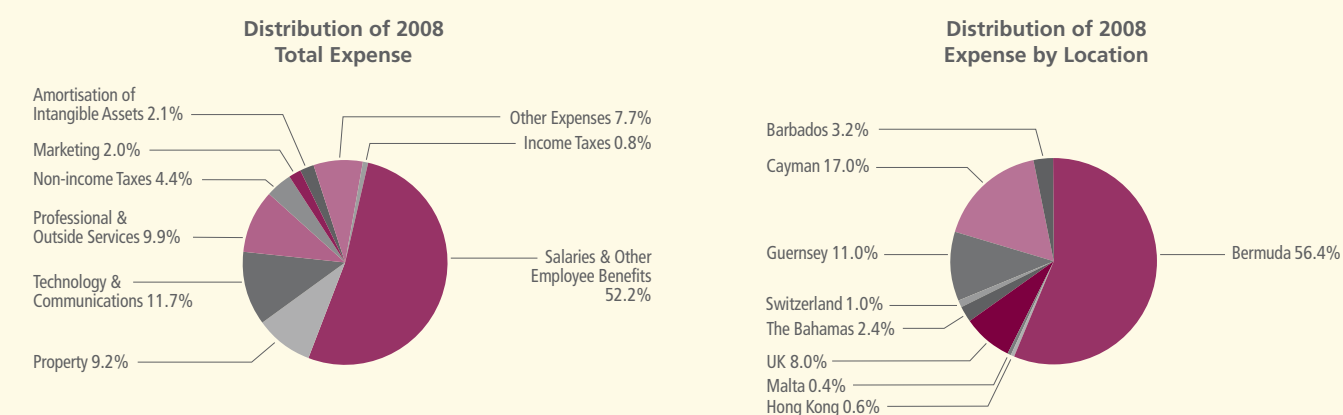
The Bank had previously viewed the mortgage-backed and other asset-backed securities markets as good sources of yield, liquidity and transparency of information on issuers and underlying collateral and had a policy of only investing in senior tranches of investment grade securities. The Bank determined in mid 2007 to cease making further investments in such securities and monitors its exposures through timely reporting, the use of industry standard models and sources of information and specialists to interpret the results of stress testing.

As at 31 December 2008 investments in collateralised mortgage obligations had a carrying value (amortised cost) of \$526.5 million, down from \$828.5 million the previous year, with a fair value of \$315.8 million, and represented 16.5% of total HTM investments. Other asset-backed securities had a carrying value (amortised cost) of \$750.3 million, with a fair value of \$601.8 million, and represented 23.5% of HTM investments. As at 31 December 2008, 92% of the Bank's investments remained in securities rated 'A' or higher.

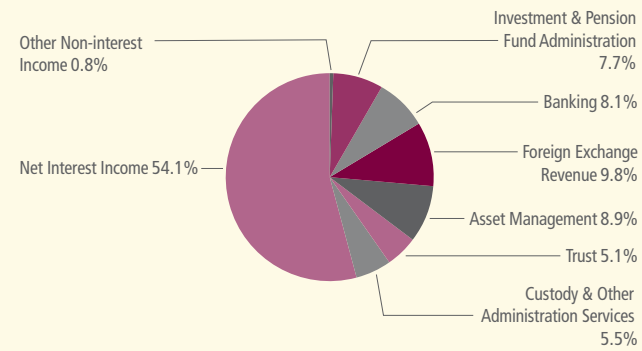
Management supplements its fair value and impairment analyses by stress testing asset-backed securities where possible using a widely employed industry modeling and analytics software tool where the fair value of securities in the HTM investment portfolio is significantly lower than amortised cost. This analytics software tool provides an extensive, accurate, and timely set of structured securities deal models and data, covering the wide range of asset backed securities, collateralised mortgage obligations, residential collateralised mortgage obligations, and collateralised debt obligations, including collateralised bond obligations and collateralised loan obligations.

Investments in mortgage-backed securities with fair values significantly lower than amortised cost were stress tested using pipeline frequency of default assumptions and loss severities from published independent third party sources such as major rating agencies. Specific risk factors of the underlying collateral were considered in other-than-temporary impairment assessments, namely the vintage of the underlying loans, the percentage of first lien loan mortgages, home owner/owner occupied properties, geographic location and diversification, loan to value ratios, FICO scores, and seniority of tranche held. Stress tests also considered expected prepayment rates and speeds, expected timelines between delinquency and liquidation, expected annual default rates, expected loss on existing balances, projected (forward) Libor rates, expected cumulative lifetime loss rates and recovery rates on default.

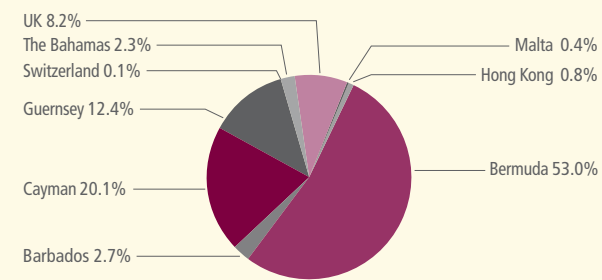
In light of continuing market instability and complexity in fair value and other-than-temporary impairment determinations, a large degree of judgment is involved in these assessments. The Bank continues to have exposures to these markets and as such there exists a level of uncertainty as to the impact of future events in these markets, and declines in the major world economies, that may affect management's views on other-than-temporary impairment, ultimately resulting in possible further write-downs to fair value.



**Distribution of 2008  
Total Revenue, Before Gains and Losses**



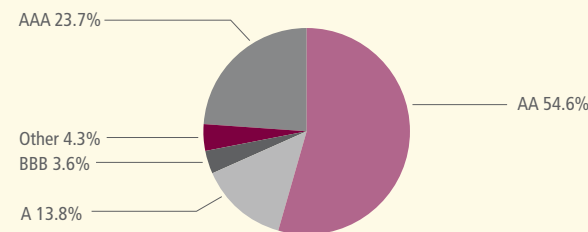
**Distribution of 2008  
Total Revenue by Location**



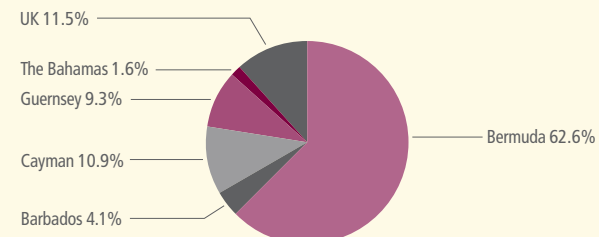
## TAXES

For the period under review the corporation tax of the Group was \$3.0 million compared to \$7.0 million for the same period a year ago, reflecting a reduction in the effective tax rate in Guernsey. Corporation taxes of \$2.0 million in the UK, \$0.9 million in Guernsey and \$0.1 million in Barbados were incurred for the year. As a result the Group's effective corporation tax rate decreased from 4.6% a year ago to 2.7% when excluding other gains and losses which were principally incurred in jurisdictions with no corporation tax. Non-income taxes of \$15.1 million were also paid across the Group, up 6.9% from \$14.2 million the previous year, primarily reflecting an increase in employee related taxes.

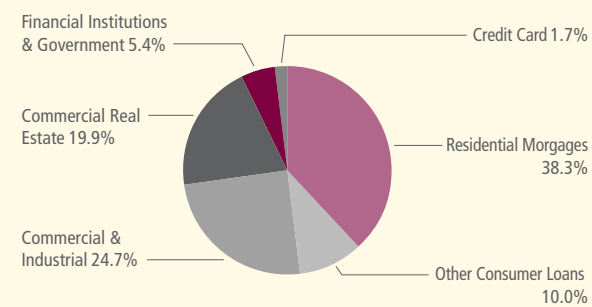
**Investment Portfolio  
by Long Term Debt Rating**



**Lending by Location**



**Group Loans by Type**



## CAPITAL

Shareholders' equity decreased by \$110.9 million, or 17.6%, year on year, primarily reflecting dividends declared of \$47.5 million, net purchases of treasury common shares of \$11.1 million and a negative movement in comprehensive income of \$55.1 million reflecting changes in the translation of foreign operations due to the decline of the UK Pound and changes in employee future benefits due to updated actuarial assumptions.

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

Weighted risk assets declined year on year by 2.3% to \$6.2 billion, primarily due to maturing investments and the impact of falling exchange rates on translation of foreign subsidiary assets, offset by an increase in the loan portfolio. The loan to the Stock Option Trust of \$34.9 million is in respect of potential obligations under the Bank's Stock Option Plan and is deducted from shareholders' equity as treasury stock. The decrease in the loan from \$41.6 million the previous year reflects \$6.7 million repayments from cash received on the exercise of stock options by employees and the effect of other share-based payments.

During the period under review, the Bank transferred 791,232 treasury shares under the Dividend Re-investment Programme, which represents a cash savings of \$11.8 million, or 20.0% of the total dividend paid. As a result of the one for ten stock dividend in February 2008; 8,943,839 new shares were issued. Under the Share Buy-Back Plan, the Bank purchased and held as treasury stock 2,562,997 shares at a cost of \$38.3 million.

At 31 December 2008, the Group's tier 1 capital ratio was 7.5% and total capital ratio was 11.2%. This level of capital meets the regulatory requirements of the Bermuda Monetary Authority. However, the Group has determined to enhance its capital position through the issuance of \$200 million qualifying tier 1 capital in the form of non cumulative preference shares. This transaction, which subject to shareholders' approval will close by 30 June 2009, will enable the Bank to create an additional capital buffer against any pronounced and prolonged economic downturn, and is consistent with a recent directive issued by the Bermuda Monetary Authority to all banks in Bermuda to increase their capital cushions.

The issuance of preference shares as a means to enhance Butterfield's long-term capital position is assured through the assistance of the Government of Bermuda, which has committed to support the offering by guaranteeing the principal of, and dividend payments on, the preference shares. In addition, the Government has committed to purchase any preference shares from this offering that are not subscribed by private investors. Butterfield expects to obtain the necessary shareholder approvals for this capital raise. On a pro forma basis, as at 31 December 2008, the issuance of these preference shares would have raised Butterfield's tier 1 capital ratio to 10.6% and its total capital ratio to 15.1%.

### Capital Composition

(In \$ thousands)

For the year ended 31 December	2008	2008	2007
	Proforma	Actual	
Tier 1 capital	663,468	463,468	547,801
Tier 2 capital	307,235	256,673	296,922
Deductions *	(26,465)	(26,465)	(21,413)
<b>Total capital</b>	<b>944,238</b>	<b>693,676</b>	823,310

### Weighted Risk Assets

(In \$ thousands)

Cash and inter-bank placements	469,371	429,371	487,158
Investments	1,587,976	1,587,976	1,795,446
Loans	3,415,452	3,415,452	3,169,395
Other assets	316,780	316,780	360,335
Off-balance sheet items	450,384	450,384	533,420
<b>Total weighted risk assets</b>	<b>6,239,963</b>	<b>6,199,963</b>	6,345,754

### Capital Ratios (%)

Tier 1	10.6%	7.5%	8.6%
Tier 2	4.9%	4.1%	4.7%
Deductions *	(0.4%)	(0.4%)	(0.3%)
<b>Total</b>	<b>15.1%</b>	<b>11.2%</b>	13.0%

\* Deductions from capital comprise investments in affiliates

## FINANCIAL OVERVIEW

### Selected Quarterly Results of Operations

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

Quarter ended	2008			
	31 December	30 September	30 June	31 March
Net interest income after provision for credit losses	62,908	60,009	61,209	67,310
Non-interest income	42,531	52,010	59,545	58,855
Total non-interest expense	68,915	96,396	94,420	90,756
Net income before gains and losses	36,524	15,623	26,334	35,409
Other gains and losses	(131,965)	64,829	(42,832)	917
Net income for the quarter	(95,441)	80,452	(16,498)	36,326

#### Earnings per share (\$) \*

Basic	(1.03)	0.87	(0.18)	0.39
Diluted	(1.01)	0.86	(0.18)	0.38
Return on shareholders' equity (%)	(60.5)	51.1	(10.4)	22.9

#### Earnings per share before other gains (losses)(\$) \*

Basic	0.40	0.17	0.28	0.38
Diluted	0.39	0.17	0.28	0.38
Return on shareholders' equity before other gains (losses) (%)	23.1	9.9	16.6	22.3

Quarter ended	2007			
	31 December	30 September	30 June	31 March
Net interest income after provision for credit losses	65,924	63,786	61,649	59,258
Non-interest income	60,239	55,358	53,534	50,551
Total non-interest expense	87,289	81,378	80,140	75,161
Net income before gains and losses	38,874	37,766	35,043	34,648
Other gains and losses	(4,118)	1,880	866	1,036
Net income for the quarter	34,756	39,646	35,909	35,684

#### Earnings per share (\$) \*

Basic	0.37	0.43	0.38	0.38
Diluted	0.36	0.42	0.37	0.37
Return on shareholders' equity (%)	22.9	27.1	25.1	25.8

#### Earnings per share before other gains (losses)(\$) \*

Basic	0.42	0.41	0.37	0.37
Diluted	0.40	0.40	0.37	0.36
Return on shareholders' equity before other gains (losses) (%)	25.6	25.8	24.5	25.0

\* All prior period per share data have been restated to reflect the one for ten stock dividend in February 2008 and the three for one stock split in August 2007.

## FINANCIAL SUMMARY

(In \$ thousands, except per share data)

Year ended 31 December	2008	2007	2006	2005	2004
<b>At year end</b>					
Cash and deposits with banks	2,221,390	2,517,012	3,151,191	2,849,920	2,396,724
Investments	3,824,079	4,744,989	3,786,793	2,916,399	3,266,400
Loans, net of allowance for credit losses	4,418,277	4,124,764	3,760,745	3,085,594	2,645,331
Premises, equipment and computer software	197,155	215,379	171,326	141,708	126,031
Total assets	10,911,844	11,910,920	11,132,802	9,197,566	8,630,383
Total deposits	9,801,269	10,747,971	10,042,832	8,240,109	7,907,450
Subordinated capital and senior debt	282,296	284,191	280,168	278,679	142,333
Shareholders' equity	518,440	629,330	549,553	495,226	428,030

#### For the year

Net interest income after provision for credit losses	251,436	250,617	215,221	182,174	148,075
Fee and other income	103,890	219,346	199,831	172,955	163,090
Salaries and other employee benefits	183,152	184,751	162,504	144,331	127,459
Other non-interest expenses	167,335	139,217	118,465	101,447	93,240
Net income before gains and losses	113,890	146,331	127,906	108,495	83,863
Other gains and losses	(109,051)	(336)	6,177	856	6,603
Net income after other gains and losses	4,839	145,995	134,083	109,351	90,466
Dividends paid	57,733	54,366	46,496	38,504	32,217

#### Financial ratios

Return on assets	0.04%	1.2%	1.3%	1.2%	1.1%
Return on shareholders' equity	0.8%	25.2%	24.6%	23.6%	21.2%
Total capital funds to total assets ratio	7.3%	7.7%	7.5%	8.4%	6.6%
Tier 1 capital ratio	10.6%	8.6%	8.9%	8.6%	7.3%
Total capital ratio	11.2%	13.0%	13.5%	13.1%	10.7%
Efficiency ratio	72.8%	65.7%	64.8%	66.4%	69.1%

#### Per share (\$) \*

Net income (diluted)	0.05	1.53	1.39	1.16	0.96
Dividends declared **	0.56	0.64	0.60	0.56	0.52
Net book value	5.64	6.76	5.87	5.36	4.72

#### Number of employees

Bermuda	803	843	845	789	786
Overseas	889	1,007	885	808	766
Total	1,692	1,850	1,730	1,597	1,552

#### Shareholder data

Number of shareholders	4,465	4,201	3,915	3,878	3,778
Number of common shares (in thousands) *	91,927	84,553	28,375	25,429	22,745

\* Actual outstanding; excludes common shares held as treasury stock and common shares held by the Bank's Stock Option Trust.

\*\*4¢ payable in shares for 2008.

All prior period per share data, with the exception of dividends, have been restated to reflect the one for ten stock dividends in February 2008, August 2006, 2005 and 2004.

All prior period per share data have been restated to reflect the three for one stock split in August 2007.

The number of shares in 2007 increased primarily due to the three for one stock split.

## 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.

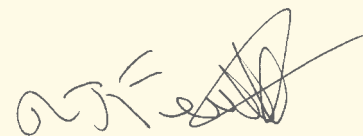
The Audit & Compliance Committee, composed entirely of directors who are not employees of the Bank, reviews the financial statements before such statements are approved by the Board of Directors and submitted to the Bank's shareholders. The Committee meets and consults regularly with Management, the 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  
5 March 2009



**Richard J. Ferrett**  
Executive Vice President & Chief Financial Officer  
5 March 2009

## INDEPENDENT AUDITORS' REPORT TO THE SHAREHOLDERS

**PRICEWATERHOUSECOOPERS** 

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Chartered Accountants  
Dorchester House  
7 Church Street  
Hamilton HM 11  
Bermuda  
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Facsimile +1 (441) 295 1242  
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### 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, of 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** and its subsidiaries at 31 December 2008 and 2007, 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 Bank's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these financial 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**

**5 March 2009**

A list of partners can be obtained from the above address.  
"PricewaterhouseCoopers" refers to PricewaterhouseCoopers (a Bermuda partnership) or, as the context requires, the PricewaterhouseCoopers global network or other member Firms of the network, each of which is a separate and independent legal entity.

## CONSOLIDATED BALANCE SHEET

As at 31 December (In \$ thousands)

	2008	2007
<b>Assets</b>		
Cash and demand deposits with banks	572,441	267,261
Term deposits with banks	1,648,949	2,249,751
Total cash and deposits with banks	2,221,390	2,517,012
Investments		
Trading	48,329	58,534
Available for sale	579,799	932,238
Held to maturity	3,195,951	3,754,217
Total investments	3,824,079	4,744,989
Loans, net of allowance for credit losses	4,418,277	4,124,764
Premises, equipment and computer software	197,155	215,379
Accrued interest	39,567	68,597
Goodwill	14,364	25,260
Intangible assets	57,250	81,230
Other assets	139,762	133,689
<b>Total assets</b>	<b>10,911,844</b>	<b>11,910,920</b>
<b>Liabilities</b>		
Deposits		
Non-interest bearing	920,866	1,042,062
Interest bearing		
Customers	8,485,309	9,399,517
Banks	395,094	306,392
Total deposits	9,801,269	10,747,971
Employee future benefits	120,038	98,063
Accrued interest	24,931	34,774
Dividend payable	3,819	14,081
Other liabilities	161,051	102,510
Total other liabilities	309,839	249,428
Subordinated capital	282,296	284,191
<b>Total liabilities</b>	<b>10,393,404</b>	<b>11,281,590</b>
<b>Shareholders' equity</b>		
Common share capital (\$1.00 par: Authorised shares 260,000,000 (31 December 2007 100,000,000))	98,400	89,456
Additional paid in capital	604,116	455,114
Retained earnings (accumulated deficit)	(35,006)	167,607
Less: treasury common stock	(82,700)	(71,576)
Accumulated other comprehensive loss	(66,370)	(11,271)
<b>Total shareholders' equity</b>	<b>518,440</b>	<b>629,330</b>
<b>Total liabilities and shareholders' equity</b>	<b>10,911,844</b>	<b>11,910,920</b>

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



Robert A. Mulderig  
Chairman of the Board



Robert Steinhoff  
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)

	2008	2007
<b>Non-interest income</b>		
Asset management	41,308	38,260
Banking	37,562	37,119
Foreign exchange revenue	45,475	38,717
Investment and pension fund administration	35,583	49,256
Trust	23,578	22,988
Custody and other administration services	25,490	24,316
Other non-interest income	3,945	9,026
<b>Total non-interest income</b>	<b>212,941</b>	<b>219,682</b>
<b>Interest income</b>		
Loans	264,570	284,695
Investments	193,006	253,831
Deposits with banks	80,519	124,608
Total interest income	538,095	663,134
<b>Interest expense</b>		
Deposits	269,668	395,681
Subordinated capital	13,946	14,853
Total interest expense	283,614	410,534
<b>Net interest income before provision for credit losses</b>	<b>254,481</b>	<b>252,600</b>
Provision for credit losses	(3,045)	(1,983)
<b>Net interest income after provision for credit losses</b>	<b>251,436</b>	<b>250,617</b>
<b>Revenue before gains and losses</b>	<b>464,377</b>	<b>470,299</b>
Gain on sale of subsidiaries and affiliate	115,479	170
Goodwill impairment	(5,220)	-
Realised / unrealised (losses) gains on trading securities	(6,356)	3,221
Realised / unrealised losses on held to maturity investments	(151,772)	-
Net other losses	(61,182)	(3,727)
<b>Total revenue</b>	<b>355,326</b>	<b>469,963</b>
<b>Non-interest expense</b>		
Salaries and other employee benefits	183,152	184,751
Technology and communications	41,149	28,741
Professional and outside services	34,529	22,304
Property	32,140	30,856
Non-income taxes	15,132	14,152
Amortisation of intangible assets	7,316	6,916
Marketing	7,140	7,131
Other expenses	26,887	22,140
<b>Total non-interest expense</b>	<b>347,445</b>	<b>316,991</b>
<b>Net income before income taxes</b>	<b>7,881</b>	<b>152,972</b>
Income taxes	(3,042)	(6,977)
<b>Net income</b>	<b>4,839</b>	<b>145,995</b>
<b>Earnings per share</b>		
Basic	0.05	1.56
Diluted	0.05	1.53

Earnings per share comparative figures have been restated for the one for ten stock dividend in February 2008.

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



## CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

For the year ended 31 December (In \$ thousands)

	2008	2007
Common share capital Authorised: 260,000,000 shares (2007: 100,000,000) of par value \$1 each		
<b>Issued</b>		
Issued and outstanding at beginning of year (January 2008: 89,456,019 shares; January 2007: 29,869,754 shares)	89,456	29,870
Dividend reinvestment (December 2008: 791,232 shares; December 2007: 306,914 shares) of which issued from treasury common stock (December 2008: 791,232 shares; December 2007: 232,392 shares)	791 (791)	307 (232)
Stock dividend (December 2008: 8,943,839 shares; December 2007: nil shares)	8,944	-
Stock split (December 2008: nil shares; December 2007: 59,637,346 shares)	-	59,637
Shares repurchased and cancelled (December 2008: nil shares; December 2007: 125,603 shares)	-	(126)
<b>Issued and outstanding at end of year</b> (December 2008: 98,399,858 shares; December 2007: 89,456,019 shares)	<b>98,400</b>	89,456
<b>Additional paid in capital</b>		
Balance at beginning of year	455,114	514,872
Dividend reinvestment of which related to treasury common stock	12,845 (12,845)	12,403 (8,197)
Stock split	-	(59,637)
Stock dividend	149,969	-
Issued under directors' and executive officers' and employees' stock option plans	3,561	2,959
Stamp duty paid in order to increase authorised common share capital	(800)	-
Reduction of additional paid in capital on transfer and sale of treasury shares	(3,728)	-
Common shares repurchased and cancelled	-	(7,286)
<b>Balance at end of year</b>	<b>604,116</b>	455,114
<b>Retained earnings (accumulated deficit)</b>		
Appropriated - general reserve	100,000	100,000
Unappropriated at beginning of year	67,607	(23,119)
Effect of changing employee future benefit plans' measurement date	(1,068)	-
Net income for year	4,839	145,995
Cash dividends declared	(47,471)	(55,269)
Stock dividend	(158,913)	-
<b>Balance at end of year</b>	<b>(35,006)</b>	167,607
<b>Treasury common stock</b>		
Balance at beginning of year (January 2008: 4,903,324 shares; January 2007: 1,494,584 shares)	(71,576)	(37,039)
Net purchases	(11,124)	(34,537)
<b>Balance at end of year</b> (December 2008: 6,473,180 shares; December 2007: 4,903,324 shares)	<b>(82,700)</b>	(71,576)
<b>Accumulated other comprehensive loss</b>		
Balance at beginning of year	(11,271)	(35,031)
Net change in unrealised gains and losses on translation of net investment in foreign operations	(21,104)	542
Net change in unrealised gains and losses on available for sale securities	153	(398)
Net change in unrealised gains and losses on cash flow hedges	-	38
Net change in employee future benefits	(34,148)	23,578
<b>Balance at end of year</b>	<b>(66,370)</b>	(11,271)
<b>Total shareholders' equity</b>	<b>518,440</b>	629,330
<b>Comprehensive (loss) income</b>		
Net income	4,839	145,995
Other comprehensive (loss) income	(55,099)	23,760
<b>Total comprehensive (loss) income</b>	<b>(50,260)</b>	169,755

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)

	2008	2007
<b>Cash flows from operating activities</b>		
Net income	4,839	145,995
Adjustments to reconcile net income to cash provided by operating activities		
Depreciation and amortisation	28,985	27,536
Goodwill impairment	5,220	-
Write down of computer software	29,180	-
Decrease (increase) in carrying value of investments in affiliates	2,223	(1,051)
Share-based compensation	6,139	5,670
Gain on sale of subsidiaries and affiliate	(115,479)	(170)
Loss (gain) on sale of premises and equipment	937	(569)
Realised and unrealised net gains on private equity investments	(21,619)	(4,388)
Loss on credit derivative instruments	52,275	6,250
Realised and unrealised losses on held to maturity investments	151,772	-
Provision for credit losses (recoveries)	3,045	1,983
Decrease (increase) in accrued interest receivable	23,017	(4,069)
Increase in other assets	(20,991)	(15,608)
(Decrease) increase in accrued interest payable	(6,672)	1,114
Increase (decrease) in other liabilities	53,589	(2,977)
	<b>196,460</b>	159,716
Net change in trading account securities	53,120	(1,872)
<b>Cash used in operating activities</b>	<b>249,580</b>	157,844
<b>Cash flows from investing activities</b>		
Net decrease in term deposits with banks	372,342	573,681
Net additions to premises, equipment and computer software	(37,915)	(59,152)
Net increase in loans	(592,358)	(348,491)
Held to maturity securities: proceeds from maturities	4,284,395	1,980,152
Held to maturity securities: purchases	(4,104,788)	(2,981,357)
Available for sale securities: proceeds from sale and maturities	5,834,046	4,019,843
Available for sale securities: purchases	(5,721,918)	(3,964,763)
Proceeds on sale of private equity investment	12,873	4,388
Proceeds on sale of subsidiaries	133,000	2,344
Purchase of subsidiary	-	(28,353)
<b>Cash provided by (used in) investing activities</b>	<b>179,677</b>	(801,708)
<b>Cash flows from financing activities</b>		
Net (decrease) increase in demand and term deposit liabilities	(41,440)	664,323
Issuance of subordinated capital	78,000	-
Repayment of subordinated capital	(78,000)	-
Proceeds from dividend re-investment plan	11,765	12,478
Stamp duty paid to increase authorised share capital	(800)	-
Proceeds from sale of treasury shares	4,994	-
Shares repurchased	(38,339)	(45,564)
Treasury stock	4,149	(7,293)
Cash dividend paid	(57,733)	(54,366)
<b>Cash (used in) provided by financing activities</b>	<b>(117,404)</b>	569,578
Effect of exchange rates on cash and demand deposits with banks	(6,673)	(35)
<b>Net increase (decrease) in cash and demand deposits with banks</b>	<b>305,180</b>	(74,321)
<b>Cash and demand deposits with banks: beginning of period</b>	<b>267,261</b>	341,582
<b>Cash and demand deposits with banks: end of period</b>	<b>572,441</b>	267,261
<b>Supplemental disclosure of cash flow information</b>		
Cash interest paid	278,869	411,082
Cash income tax paid	3,808	5,428

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

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the years ended 31 December 2008 and 2007 (All amounts are expressed in thousands of Bermuda dollars unless otherwise stated)

### NOTE 1: SIGNIFICANT ACCOUNTING POLICIES

#### (a) Basis of Presentation and Use of Estimates and Assumptions

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, including the provision for credit losses, the fair value of financial instruments, the fair value of investments, litigation provisions, variable interest entities, pensions and post-retirement medical benefit plan benefits, the carrying value of goodwill and intangible assets require management to make subjective or complex judgments and 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 because the Bank is not the beneficiary of these assets.

#### (e) Investments

Investments include debt and equity securities. Debt securities include bonds, notes, certificates of deposit, redeemable preferred stock, as well as certain loan or asset backed and structured securities subject to prepayment, credit and default 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. Debt securities and marketable equity securities classified as "available for sale" are carried at fair value, with unrealised gains and losses reported in other comprehensive income, with the exception of other-than-temporary impairments which are included in net 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 of investments is determined in accordance with note 1 p).

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.

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

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 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 lending portfolio. 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 allowance 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 provision for credit losses.

#### (i) General Allowance

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, instalment, revolving credit, and most other consumer loans, is collectively evaluated for impairment. The allowance for credit losses attributed to these loans is established via a process that estimates the probable losses inherent and incurred in the portfolio, based upon various analyses. Management considers overall portfolio indicators including historical credit losses; delinquent (defined as loans 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 more frequently if events or circumstances indicate there may be impairment. If the carrying amount of a reporting unit, including the allocated goodwill, exceeds its fair value, goodwill impairment is measured as the excess of the carrying amount of the reporting unit's allocated goodwill over the implied fair value of the goodwill. Other acquired intangible assets with finite lives are amortised on a straight-line basis over their estimated useful lives, not exceeding 15 years. Intangible assets' estimated lives are re-evaluated annually and an impairment test is carried out if certain indicators of impairment exist.

#### (k) Premises, Equipment and Computer Software

Land, 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 Statement of Financial Accounting Standard (SFAS) No. 34 Capitalisation of Interest Cost (SFAS 34).

#### (l) Derivatives

In accordance with SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities (SFAS 133), all derivatives are recognised on the Consolidated Balance Sheet at their fair value. SFAS 133, as amended by SFAS No. 138 Accounting for Certain Derivative Instruments and Certain Hedging Activities (SFAS 138) and SFAS No. 149 Amendment of Statement 133 on Derivative Instruments and Hedging Activities (SFAS 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 trustee 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 SFAS No. 87 Employers' Accounting for Pensions (SFAS 87) and SFAS No. 88 Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits (SFAS 88). Its post-retirement medical and life insurance plans are accounted for in accordance with SFAS No. 106 Employers' Accounting for Post-retirement Benefits Other Than Pensions (SFAS 106). Both plans are also accounted for in accordance with SFAS No. 158 (SFAS 158), Employers' Accounting for Defined Benefit Pension and Other Post-retirement Plans, an amendment of FASB Statements No. 87, 88, 106 and 132(R).

Expense for the defined benefit pension plans and the post-retirement medical benefits plan is comprised of (a) the actuarially determined benefits for the current year's service, (b) imputed interest on the actuarially determined liability of the plan, (c) in the case of the defined benefit pension plans, the expected investment return on the 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 revised accounting standards.

For each of the defined benefit pension plans and for the post-retirement medical benefits plan, the asset (liability) recognised for accounting purposes is reported in other assets and employee future benefits.

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

#### **(n) Share-Based Compensation**

The Bank has a number of share-based compensation plans for eligible employees. In accordance with SFAS No. 123(R) Share-Based Payment (SFAS 123(R)), the Bank follows the fair value method of accounting for share-based compensation plans. The fair value of share-based awards that eventually vest is amortised over the vesting period of the award.

#### **(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 SFAS No. 91 Accounting for Non-refundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases (SFAS 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**

SFAS 157 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The Bank determines the fair values of its financial instruments based on the fair value hierarchy established in SFAS 157 which requires an entity to maximise the use of observable inputs and minimise the use of unobservable inputs when measuring fair value. The standard describes three levels of inputs that may be used to measure fair value. The Bank carries at fair value investments classified as trading and available for sale, and derivative assets and liabilities. The Bank carries a private equity investment in a credit card company at fair value in accordance with SFAS 159.

#### **Level 1, 2 and 3 valuation inputs**

Financial instruments are considered Level 1 when valuation can be based on unadjusted quoted prices in active markets for identical assets or liabilities. Level 2 financial instruments are valued using quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data of substantially the full term of the assets or liabilities. Financial instruments are considered Level 3 when their values are determined using pricing models, discounted cash flow methodologies or similar techniques and at least one significant model assumption or input is unobservable and when determination of the fair value requires significant management judgment or estimation.

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

#### **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.

#### **Investments**

The fair values of investments are determined based on observable quoted prices for identical assets or liabilities in active markets when available. If unavailable, observable inputs from similar items in active markets or identical/similar items with inactive markets are used. In the absence of observable quoted prices unobservable inputs are used.

#### **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.

#### **Accrued interest**

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

#### **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.

#### **Subordinated capital**

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

#### **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 to the Bank.

## Business units

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

## (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 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.

On 1 January 2007, the Bank adopted the provisions of FASB Interpretation No. 48 Accounting for Uncertainty in Income Taxes (FIN 48). Accordingly, the Bank initially recognises the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. The adoption of FIN 48 did not result in the derecognition of tax positions for accounting purposes. The Bank recognises interest accrued and penalties related to unrecognised tax benefits in operating expenses.

## (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 common shares outstanding during the year and adjusted for the stock split and the stock dividend declared during the years ended 31 December 2008 and 2007 (see also Notes 18 and 23). The dilutive effect of share-based compensation plans was calculated using the treasury stock method, whereby the proceeds received from the exercise of share-based awards are assumed to be used to repurchase outstanding common shares, using the quarterly average market price of the Bank's shares for the period.

## (u) Consolidation of Variable Interest Entities

FIN 46(R) requires beneficiaries of variable interests 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 a periodic 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 AND DIVESTITURES

### Divestiture of Fund Services Businesses

On 11 September 2008, the Bank completed the sale and merger of its Bermuda-based and international Fund Services businesses with those of Fulcrum Group to form the new company, Butterfield Fulcrum Group. In relation with this transaction, the Bank has recognised a gain of \$115.5 million which is included in Gain on sale of subsidiaries and affiliate in the Statement of Income.

The Bank received a 40% ownership interest in Butterfield Fulcrum Group (on a fully diluted basis) and an upfront cash payment of \$133 million. The Bank loaned Fulcrum Group \$65 million on commercial market terms to finance a portion of the cash proceeds. The Bank's Fund Services businesses sold were previously reported under the Wealth Management & Fiduciary Services and Investment & Pension Fund Administration segment. The equity ownership in Butterfield Fulcrum Group is also reported in the Wealth Management & Fiduciary Services and Investment & Pension Fund Administration segment. A transitional services agreement provides for certain key services such as information technology support, human resources support and premises to continue over an 18-month period, the value of which was deducted from the gain.

### Acquisition of Bentley Reid Group Limited

On 29 October 2007, the Bank acquired all outstanding shares of Bentley Reid Group Limited (Bentley Reid), a privately-held, international wealth management company with offices in Hong Kong, London and Malta, for consideration of £13.8 million (\$28.4 million) paid in cash. The purchase agreement provides for contingent payments in years 2009 and 2010 of up to £5.3 million (\$7.73 million). Management has assessed that the contingency amounts are not probable and therefore have not been accounted for at this time. The payments will be accounted for as and when they are probable and will be recorded as additional goodwill at that time.

The following table summarises the total consideration in respect of the acquisition of Bentley Reid:

	<u>Bentley Reid</u>
<b>Fair value of assets acquired</b>	
Cash and deposits with banks	9,154
Premises, equipment and computer software	2,069
Intangible assets - customer relationships	17,705
Other assets	2,206
<b>Total assets</b>	<b>31,134</b>
<b>Fair value of liabilities assumed</b>	
Other liabilities	2,781
<b>Fair value of identifiable net assets acquired</b>	<b>28,353</b>
<b>Total purchase consideration</b>	<b>28,353</b>

## NOTE 3: CASH AND DEPOSITS WITH BANKS

31 December	2008			2007		
	Bermuda	Non-Bermuda	Total	Bermuda	Non-Bermuda	Total
<b>Unrestricted</b>						
<b>Non-interest earning</b>						
Cash and demand deposits	<b>119,737</b>	<b>23,651</b>	<b>143,388</b>	56,667	41,622	98,289
<b>Interest earning</b>						
Deposits maturing within three months and on demand	<b>18,964</b>	<b>1,998,496</b>	<b>2,017,460</b>	255,443	2,010,071	2,265,514
Deposits maturing between three to six months	-	<b>19,591</b>	<b>19,591</b>	-	43,117	43,117
Deposits maturing between six to twelve months	-	<b>3,303</b>	<b>3,303</b>	-	64,123	64,123
Sub-total - Interest earning	<b>18,964</b>	<b>2,021,390</b>	<b>2,040,354</b>	255,443	2,117,311	2,372,754
<b>Total unrestricted cash and deposits</b>	<b>138,701</b>	<b>2,045,041</b>	<b>2,183,742</b>	312,110	2,158,933	2,471,043
<b>Affected by drawing restrictions related to minimum reserve and derivative margin requirements</b>						
<b>Non-interest earning</b>						
Demand deposits	-	<b>19,289</b>	<b>19,289</b>	-	27,876	27,876
<b>Interest earning</b>						
Deposits maturing within three months	<b>17,009</b>	<b>1,350</b>	<b>18,359</b>	5,032	13,061	18,093
<b>Total restricted deposits</b>	<b>17,009</b>	<b>20,639</b>	<b>37,648</b>	5,032	40,937	45,969
<b>Total cash and deposits with banks</b>	<b>155,710</b>	<b>2,065,680</b>	<b>2,221,390</b>	317,142	2,199,870	2,517,012

**NOTE 4: INVESTMENTS**

The following table presents securities by remaining term to maturity:

31 December 2008	Remaining term to maturity					Carrying value
	Within 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity	
<b>Trading</b>						
Debt securities issued by non-US governments	-	731	3,945	3,186	-	7,862
Corporate securities and other	-	-	-	-	40,467	40,467
<b>Total trading</b>	-	731	3,945	3,186	40,467	48,329
<b>Available for sale</b>						
Certificates of deposit	471,249	95,959	-	-	-	567,208
Debt securities issued by non-US governments	9,773	-	-	-	-	9,773
Equity securities	-	-	-	-	2,818	2,818
<b>Total available for sale</b>	481,022	95,959	-	-	2,818	579,799
<b>Held to maturity</b>						
US government and federal agencies / corporations	-	-	38,129	75,558	-	113,687
Certificates of deposit	51,000	304,000	156,406	-	-	511,406
Collateralised mortgage obligations	3,675	61,611	164,411	296,784	-	526,481
Debt securities issued by non-US governments	-	6,275	12,083	13,293	-	31,651
Corporate debt securities	187,073	326,723	739,911	6,326	2,356	1,262,389
Other, primarily asset-backed securities	15,416	26,960	449,572	258,389	-	750,337
<b>Total held to maturity</b>	257,164	725,569	1,560,512	650,350	2,356	3,195,951
<b>Total investments</b>	738,186	822,259	1,564,457	653,536	45,641	3,824,079
<b>Total by currency</b>						
Bermuda dollars	-	-	-	-	440	440
US dollars	376,492	712,447	1,324,334	542,955	37,631	2,993,859
Other	361,694	109,812	240,123	110,581	7,570	829,780
<b>Total investments</b>	738,186	822,259	1,564,457	653,536	45,641	3,824,079

31 December 2007	Remaining term to maturity					Carrying value
	Within 3 months	3 to 12 months	1 to 5 years	Over 5 years	No specific maturity	
<b>Trading</b>						
Debt securities issued by non-US governments	-	731	4,304	5,572	-	10,607
Corporate securities and other	-	-	-	-	47,927	47,927
<b>Total trading</b>	-	731	4,304	5,572	47,927	58,534
<b>Available for sale</b>						
Certificates of deposit	669,729	248,344	-	-	-	918,073
Debt securities issued by non-US governments	11,996	-	-	-	-	11,996
Corporate debt securities	-	-	-	1,838	-	1,838
Equity securities	-	-	-	-	331	331
<b>Total available for sale</b>	681,725	248,344	-	1,838	331	932,238
<b>Held to maturity</b>						
US government and federal agencies / corporations	-	59,987	4,496	136,248	-	200,731
Certificates of deposit	81,152	149,260	-	-	-	230,412
Collateralised mortgage obligations	-	-	87,699	740,781	-	828,480
Debt securities issued by non-US governments	19,997	22,205	14,395	17,827	1,887	76,311
Corporate debt securities	186,419	206,082	1,346,894	45,981	-	1,785,376
Other, primarily asset-backed securities	90,831	18,335	49,986	473,755	-	632,907
<b>Total held to maturity</b>	378,399	455,869	1,503,470	1,414,592	1,887	3,754,217
<b>Total investments</b>	1,060,124	704,944	1,507,774	1,422,002	50,145	4,744,989
<b>Total by currency</b>						
Bermuda dollars	-	-	-	-	492	492
US dollars	270,411	352,388	1,160,218	1,249,561	45,323	3,077,901
Other	789,713	352,556	347,556	172,441	4,330	1,666,596
<b>Total investments</b>	1,060,124	704,944	1,507,774	1,422,002	50,145	4,744,989

Investments at carrying value includes \$2,536 million (2007: \$3,062 million) of floating-rate instruments and \$1,248 million (2007: \$1,634 million) of fixed-rate instruments. The approximate yield on floating-rate securities at 31 December 2008 was 2.25% (2007: 5.22%), while the approximate yield on fixed-rate securities was 4.10% (2007: 5.67%).

Certificates of deposit with a carrying value of \$44.4 million included in the held to maturity category are restricted from sale in accordance with a credit enhancement agreement.

The cost of available for sale securities, the amortised cost of held to maturity securities and their estimated fair values were as follows:

	2008				2007			
	Cost	Gross unrealised gains	Gross unrealised losses	Fair value	Cost	Gross unrealised gains	Gross unrealised losses	Fair value
<b>31 December</b>								
<b>Available for sale</b>								
Certificates of deposit	565,321	2,017	(130)	567,208	916,187	2,004	(118)	918,073
Debt securities issued by non-US governments	9,773	-	-	9,773	11,996	-	-	11,996
Corporate debt securities	-	-	-	-	1,838	-	-	1,838
Equity securities	2,818	-	-	2,818	192	139	-	331
<b>Total available for sale</b>	<b>577,912</b>	<b>2,017</b>	<b>(130)</b>	<b>579,799</b>	<b>930,213</b>	<b>2,143</b>	<b>(118)</b>	<b>932,238</b>

	2008				2007			
	Amortised cost	Gross unrealised gains	Gross unrealised losses	Fair value	Amortised cost	Gross unrealised gains	Gross unrealised losses	Fair value
<b>31 December</b>								
<b>Held to maturity</b>								
US government and federal agencies / corporations	113,687	28	(3,784)	109,931	200,731	113	(821)	200,023
Certificates of deposit	511,406	2,812	-	514,218	230,412	133	(48)	230,497
Collateralised mortgage obligations	526,481	372	(211,060)	315,793	828,480	719	(115,976)	713,223
Debt securities issued by non-US governments	31,651	551	(53)	32,149	76,311	809	(36)	77,084
Corporate debt securities	1,262,389	2,091	(79,763)	1,184,717	1,785,376	853	(14,317)	1,771,912
Other, primarily asset-backed securities	750,337	-	(148,523)	601,814	632,907	25	(33,691)	599,241
<b>Total held to maturity</b>	<b>3,195,951</b>	<b>5,854</b>	<b>(443,183)</b>	<b>2,758,622</b>	<b>3,754,217</b>	<b>2,652</b>	<b>(164,889)</b>	<b>3,591,980</b>

The following table shows the fair value and gross unrealised losses of the Bank's investments with unrealised losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealised loss position:

	Less than 12 months		12 months or more		Total fair value	Total gross unrealised losses
	Fair value	Gross unrealised losses	Fair value	Gross unrealised losses		
<b>31 December 2008</b>						
<b>Available for sale</b>						
Certificates of deposit	125,310	(130)	-	-	125,310	(130)
<b>Held to maturity</b>						
US government and federal agencies / corporations	16,065	(874)	90,065	(2,910)	106,130	(3,784)
Collateralised mortgage obligations	16,083	(2,402)	291,202	(208,657)	307,285	(211,059)
Debt securities issued by non-US governments	2,964	(36)	983	(17)	3,947	(53)
Corporate debt securities	136,722	(3,524)	885,738	(76,239)	1,022,460	(79,763)
Other, primarily asset-backed securities	44,627	(11,133)	356,771	(137,392)	401,398	(148,525)
<b>Total held to maturity securities with unrealised losses</b>	<b>216,461</b>	<b>(17,969)</b>	<b>1,624,759</b>	<b>(425,215)</b>	<b>1,841,220</b>	<b>(443,184)</b>
<b>Total securities with unrealised losses</b>	<b>341,771</b>	<b>(18,099)</b>	<b>1,624,759</b>	<b>(425,215)</b>	<b>1,966,530</b>	<b>(443,314)</b>

	Less than 12 months		12 months or more		Total fair value	Total gross unrealised losses
	Fair value	Gross unrealised losses	Fair value	Gross unrealised losses		
<b>31 December 2007</b>						
<b>Available for sale</b>						
Certificates of deposit	221,248	(118)	-	-	221,248	(118)
<b>Held to maturity</b>						
US government and federal agencies / corporations	95,228	(553)	47,287	(268)	142,515	(821)
Certificates of deposit	115,108	(48)	-	-	115,108	(48)
Collateralised mortgage obligations	509,804	(113,931)	134,776	(2,045)	644,580	(115,976)
Debt securities issued by non-US governments	-	-	40,958	(36)	40,958	(36)
Corporate debt securities	1,116,584	(12,775)	205,356	(1,542)	1,321,940	(14,317)
Other, primarily asset-backed securities	507,628	(24,900)	48,498	(8,791)	556,126	(33,691)
<b>Total held to maturity securities with unrealised losses</b>	<b>2,344,352</b>	<b>(152,207)</b>	<b>476,875</b>	<b>(12,682)</b>	<b>2,821,227</b>	<b>(164,889)</b>
<b>Total securities with unrealised losses</b>	<b>2,565,600</b>	<b>(152,325)</b>	<b>476,875</b>	<b>(12,682)</b>	<b>3,042,475</b>	<b>(165,007)</b>

Management conducts an ongoing review to identify and evaluate securities that show objective indications of impairment. An investment is written down to fair value if its unrealised losses represent impairment that is considered to be other-than-temporary.

To assess whether an other-than-temporary impairment has occurred, Management must make certain judgments and estimates and in determining whether a loss is temporary. Factors considered include the extent of the unrealised loss, current ratings from ratings agencies, the length of time that the security has been in an unrealised loss position, the financial condition of the issuer and prospects for recovery of contractual payments (principal and interest), and the Bank's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. If the decline is considered to be other-than-temporary, a write-down is recorded in the Consolidated Statement of Income.

Unrealised losses for US Government and federal agencies / corporations, Collateralised mortgage obligations, Debt securities issued by non-US governments, Corporate debt securities and Other, primarily asset-backed securities, were due to widening credit spreads caused by illiquidity and credit concerns resulting from the disruption in the financial markets, the weakening of the US housing market, and credit rating downgrades of certain securities in the marketplace. However, given that a substantial portion of these securities are investment grade securities, and the unrealised losses are primarily in higher rated securities, Management believes these losses are a result of technical spread widening rather than fundamental deterioration. The Bank has the ability and intent to hold these investments until there is a recovery of carrying value, which may be at maturity, and accordingly Management does not believe these investments to be other-than-temporarily impaired.

The fair value of the Bank's collateralised mortgage obligations related exposure depends on market conditions and assumptions that are subject to change over time. The Bank expects that market conditions will continue to evolve, and that the fair value of the Bank's positions will frequently change. The degree of judgement involved in determining the fair value of an investment security is dependent upon the availability of observable market prices or observable market parameters. When observable market prices and parameters do not exist as was the case in a number of circumstances at 31 December 2008, judgement is necessary to estimate fair value which gives rise to added uncertainty in the valuation process. The valuation process takes into consideration factors such as interest rate changes, movements in credit spreads, default rate assumptions, prepayment assumptions, type and quality of collateral, and market sentiment.

Management has supplemented its fair value and impairment analyses by stress testing mortgage-backed securities where the fair value is significantly lower than amortised cost using a widely employed industry modelling and analytics software tool. This analytics software tool provides an extensive, accurate, and timely set of structured securities deal models and data, covering the wide range of asset backed securities, collateralised mortgage obligations, residential collateralised mortgage obligations, and collateralised debt obligations (including collateralised bond obligations and collateralised loan obligations) deals.

Investments in collateralised mortgage-backed securities with fair values significantly lower than amortised cost were stress tested using pipeline default and cumulative lifetime loss severities from published independent third party sources. Specific risk factors of the underlying collateral were considered in other-than-temporary impairment assessments, specifically, the vintage of the underlying loans, the percentage of first lien loan mortgages, home owner/owner occupied properties, geographic location and diversification, loan to value ratios and FICO scores, and seniority of tranche. Stress tests also considered expected prepayment rates and speeds, expected annual default rates, expected loss on existing balances, timing of losses, projected (forward) Libor rates, expected cumulative lifetime loss rates and recovery rates between 40% - 45% on default.

During its assessment of other-than-temporary impairment Management determined that it did not have sufficient certainty that the issuers of certain securities could service all of the contractually obligated principal and interest payments. Therefore other-than-temporary impairment has taken place and these investments were written down to their fair value. Other-than-temporary impairments of \$76.392 million and \$19.783 million were recorded on the Bank's

investments in collateralised mortgage obligations and a CDO of residential mortgages held in the other, primarily asset-backed securities category respectively. Realised losses of \$23.032 million and \$32.6 million were recorded on a CDO of residential mortgages held in the other, primarily asset-backed securities category and on corporate debt securities respectively.

In respect of the following categories, except as noted in the previous paragraph, the Bank does not consider those investments to be other-than-temporarily impaired at 31 December 2008:

#### Certificates of deposit

The unrealised losses on the Bank's certificates of deposit were due to widening credit spreads caused by illiquidity and credit concerns resulting from the disruption in the financial markets. However, given that all of these securities are investment grade securities, and the Bank has the ability and intent to hold these investments until there is a recovery of carrying value, which may be at maturity, management believes that it will collect all amounts due according to the contractual terms of the investments.

#### US Government and federal agencies / corporations

The unrealised losses on the Bank's investments in US Treasury obligations and direct obligations of US government agencies were due to widening credit spreads caused by illiquidity and credit concerns resulting from the disruption in the financial markets, and the weakening of the US housing market. However, given that all of these securities are investment grade securities, and the Bank has the ability and intent to hold these investments until there is a recovery of carrying value, which may be at maturity, Management believes that it will collect all amounts due according to the contractual terms of the investments.

#### Collateralised mortgage obligations

The unrealised losses on the Bank's investments in collateralised mortgage obligations were due to widening credit spreads caused by illiquidity and credit concerns resulting from the disruption in the financial markets, the weakening of the US housing market, and credit rating downgrades of certain securities in the marketplace. However, given that a substantial portion of these securities are investment grade securities, Management assesses each security individually for impairment, and the Bank has the ability and intent to hold these investments until there is a recovery of carrying value, which may be at maturity, Management does not believe these investments to be other-than-temporarily impaired.

#### Debt securities issued by non-US governments

The unrealised losses on the Bank's investments in non-US government debt securities obligations and direct obligations of non-US government agencies were due to widening credit spreads caused by illiquidity and credit concerns resulting from the disruption in the financial markets. Given that these securities are investment grade, and the Bank has the ability and intent to hold these investments until there is a recovery of carrying value, which may be at maturity, Management does not believe these investments to be other-than-temporarily impaired.

#### Corporate debt securities

The unrealised losses on the Bank's investments in corporate bonds were due to widening credit spreads caused by illiquidity and credit concerns resulting from the disruption in the financial markets, and the weakening of the US housing market. However, given that these securities are predominantly investment grade, and the Bank has the ability and intent to hold these investments until there is a recovery of carrying value, which may be at maturity, Management does not believe these investments to be other-than-temporarily impaired.

#### Other, primarily asset-backed securities

The unrealised losses on the Bank's other investments, primarily asset-backed securities were due to widening credit spreads caused by illiquidity and credit concerns resulting from the disruption in the financial markets, the weakening of the US housing market, and credit rating downgrades of certain securities in the marketplace. However, given that a substantial portion of these securities are investment grade securities, Management assesses each security individually for impairment, and the Bank has the ability and intent to hold these investments until there is a recovery of carrying value, which may be at maturity, Management does not believe these investments to be other-than-temporarily impaired.

In February 2008 the Bank purchased from a related party, namely the AAAm rated Butterfield Money Market Fund Ltd. (BMMFL), \$75.0 million of asset backed security for fair value of \$73.565 million, and placed these securities into the held to maturity portfolio. The holdings of the asset backed security are high quality with no direct exposure to sub-prime, mid-prime, or second lien mortgages. In July 2008 the Bank purchased from BMMFL \$81.7 million of primarily collateralised mortgage obligations at fair value at the time. The Bank holds the purchased securities in its held to maturity portfolio.

Exclusive of US residential mortgage backed securities, total investments were \$3.5 billion, with a market value of \$3.3 billion on 31 December 2008. 92% of the Bank's investments remained in securities rated 'A' or higher as at 31 December 2008.

#### Significant risk and uncertainty

In its held to maturity portfolio, the Bank holds collateralised mortgage obligations (the CMO Investments) at amortised cost of \$53.4 million. Although realisation of the CMO Investments' amortised cost is not assured, Management does not believe the CMO Investments to be other-than-temporarily impaired. The amount of the CMO Investments, however, could be reduced if estimates of cumulative lifetime loss rates, losses on existing balances, loss severity, delinquency default rates or certain other factors increase in the future, and it is possible that the rate of increase could be rapid. If these factors increase and Management then determines that it is not probable that contractual interest and principal payments will be received, an other-than-temporary impairment equal to the difference between carrying value and fair market value of the CMO Investments shall be recorded in income. Management's best estimate of this amount is \$44.0 million.

Other currently non-investment grade securities in the collateralised mortgage obligation and other, primarily asset backed portfolios are not immune to future assessment for other-than-temporary impairment.

The following table presents realised and unrealised gains and losses on trading securities that were recognised during the year:

Year ended 31 December	2008	2007
<b>Realised / unrealised gains (losses) on trading securities</b>		
Equities (a)	<b>(6,356)</b>	3,252
Fixed income and other (b)	-	(31)
<b>Total</b>	<b>(6,356)</b>	3,221

(a) Includes equity securities and equity derivatives.

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

#### NOTE 5: LOANS

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

31 December	2008			2007		
	Bermuda	Non-Bermuda	Total	Bermuda	Non-Bermuda	Total
<b>Commercial loans</b>						
Commercial and industrial	<b>655,970</b>	<b>176,316</b>	<b>832,286</b>	620,973	156,245	777,218
Commercial real estate				-		
Commercial mortgage	<b>173,356</b>	<b>493,216</b>	<b>666,572</b>	194,911	588,065	782,976
Construction	<b>205,101</b>	<b>11,136</b>	<b>216,237</b>	194,130	11,351	205,481
Financial institutions	<b>154,359</b>	<b>40,440</b>	<b>194,799</b>	211,596	35,880	247,476
Government	<b>36,721</b>	<b>8,168</b>	<b>44,889</b>	15,600	3,017	18,617
Overdrafts	<b>81,692</b>	<b>182,822</b>	<b>264,514</b>	42,758	167,701	210,459
<b>Total commercial loans</b>	<b>1,307,199</b>	<b>912,098</b>	<b>2,219,297</b>	1,279,968	962,259	2,242,227
Less allowance for credit losses on commercial loans	<b>(11,953)</b>	<b>(1,554)</b>	<b>(13,507)</b>	(12,206)	(1,757)	(13,963)
<b>Total commercial loans after allowance for credit losses</b>	<b>1,295,246</b>	<b>910,544</b>	<b>2,205,790</b>	1,267,762	960,502	2,228,264
<b>Consumer loans</b>						
Automobile financing	<b>62,991</b>	<b>5,092</b>	<b>68,083</b>	59,301	6,106	65,407
Credit card	<b>54,599</b>	<b>22,663</b>	<b>77,262</b>	51,185	22,109	73,294
Mortgages	<b>1,224,148</b>	<b>477,378</b>	<b>1,701,526</b>	1,053,387	333,795	1,387,182
Overdrafts	<b>9,075</b>	<b>4,495</b>	<b>13,570</b>	7,734	6,447	14,181
Other consumer	<b>123,641</b>	<b>243,294</b>	<b>366,935</b>	80,580	288,778	369,359
<b>Total consumer loans</b>	<b>1,474,454</b>	<b>752,922</b>	<b>2,227,376</b>	1,252,187	657,235	1,909,423
Less allowance for credit losses on consumer loans	<b>(10,003)</b>	<b>(4,886)</b>	<b>(14,889)</b>	(8,965)	(3,958)	(12,923)
<b>Total consumer loans after allowance for credit losses</b>	<b>1,464,451</b>	<b>748,036</b>	<b>2,212,487</b>	1,243,222	653,277	1,896,500
<b>Total loans</b>	<b>2,781,653</b>	<b>1,665,020</b>	<b>4,446,673</b>	2,532,155	1,619,494	4,151,650
Less allowance for credit losses	<b>(21,956)</b>	<b>(6,440)</b>	<b>(28,396)</b>	(21,171)	(5,715)	(26,886)
<b>Net loans</b>	<b>2,759,697</b>	<b>1,658,580</b>	<b>4,418,277</b>	2,510,984	1,613,779	4,124,764

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 2008 is 5.72% (2007: 7.21%).

The table below sets forth information about the Bank's non-accrual loans:

31 December	2008			2007		
	Gross	Specific allowance	Total	Gross	Specific allowance	Total
Commercial loans - Bermuda	<b>2,942</b>	<b>(1,955)</b>	<b>987</b>	3,354	(2,272)	1,082
Commercial loans - Non-Bermuda	<b>5,053</b>	<b>(106)</b>	<b>4,947</b>	8,746	(201)	8,545
Consumer loans - Bermuda	<b>2,561</b>	<b>(115)</b>	<b>2,446</b>	1,416	(179)	1,237
Consumer loans - Non-Bermuda	<b>1,500</b>	<b>(598)</b>	<b>902</b>	1,381	(747)	634
Commercial and residential mortgages - Bermuda	<b>11,706</b>	<b>(165)</b>	<b>11,541</b>	11,321	(165)	11,156
Commercial and residential mortgages - Non-Bermuda	<b>12,738</b>	<b>(519)</b>	<b>12,219</b>	10,532	(300)	10,232
	<b>36,500</b>	<b>(3,458)</b>	<b>33,042</b>	36,750	(3,864)	32,886

For the year ended 31 December 2008, the amount of gross interest income that would have been recorded had impaired loans been current was \$3.4 million (2007: \$3.1 million). For the year ended 31 December 2008, the Bank recovered overdue interest of \$0.3 million (2007: \$0.4 million) on impaired loans that were repaid in the year. The average balance of impaired loans during the year ended 31 December 2008 was \$32.3 million (2007: \$34.7 million).

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

31 December	2008			2007		
	Specific allowances	General allowance	Total	Specific allowances	General allowance	Total
Allowance for credit losses at beginning of year	3,865	23,021	26,886	3,615	22,118	25,733
Provision this year	3,220	(175)	3,045	2,794	(811)	1,983
Recoveries	-	2,539	2,539	316	2,380	2,696
Charge-offs	(3,542)	(447)	(3,989)	(2,860)	(666)	(3,526)
Other	(85)	-	(85)	-	-	-
<b>Allowance for credit losses at end of year</b>	<b>3,458</b>	<b>24,938</b>	<b>28,396</b>	<b>3,865</b>	<b>23,021</b>	<b>26,886</b>

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

31 December	2008			2007		
	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	3,817	370	1,696	6,001	788	1,534
Automobile financing	1,264	1,046	445	2,563	1,524	238
Other consumer and mortgages	38,678	22,585	1,743	51,854	19,668	1,126
Consumer loans	43,759	24,001	3,884	60,418	21,980	2,898
Commercial loans	26,634	14,930	105	35,694	16,293	628
<b>Total loans reported</b>	<b>70,393</b>	<b>38,931</b>	<b>3,989</b>	<b>96,112</b>	<b>38,273</b>	<b>3,526</b>

#### 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 include 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	2008			2007		
	On-balance sheet	Off-balance sheet	Total credit exposure	On-balance sheet	Off-balance sheet	Total credit exposure
Banks and financial services	409,692	524,655	934,347	482,765	610,577	1,093,342
Commercial and merchandising	971,055	474,782	1,445,837	899,653	323,130	1,222,783
Governments	93,480	-	93,480	29,049	-	29,049
Individuals	2,226,198	166,725	2,392,923	1,824,497	179,814	2,004,311
Primary industry and manufacturing	32,142	4,815	36,957	57,787	37,370	95,157
Real estate	682,148	50,598	732,746	828,180	93,307	921,487
Transport and communication	28,500	5,855	34,355	25,855	2,803	28,658
Sub-total	4,443,215	1,227,430	5,670,645	4,147,786	1,247,001	5,394,787
General allowance	(24,938)	-	(24,938)	(23,022)	-	(23,022)
<b>Total</b>	<b>4,418,277</b>	<b>1,227,430</b>	<b>5,645,707</b>	<b>4,124,764</b>	<b>1,247,001</b>	<b>5,371,765</b>

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

31 December	2008			2007		
	On-balance sheet	Off-balance sheet	Total credit exposure	On-balance sheet	Off-balance sheet	Total credit exposure
Bermuda	2,779,417	766,292	3,545,709	2,529,540	661,089	3,190,629
Barbados	184,173	50,991	235,164	148,447	4,091	152,538
Cayman	483,934	186,676	670,610	351,776	137,227	489,003
Guernsey	414,536	162,661	577,197	465,663	333,850	799,513
The Bahamas	71,528	5,701	77,229	41,368	-	41,368
United Kingdom	509,627	55,109	564,736	610,992	110,744	721,736
Sub-total	4,443,215	1,227,430	5,670,645	4,147,786	1,247,001	5,394,787
General allowance	(24,938)	-	(24,938)	(23,022)	-	(23,022)
<b>Total</b>	<b>4,418,277</b>	<b>1,227,430</b>	<b>5,645,707</b>	<b>4,124,764</b>	<b>1,247,001</b>	<b>5,371,765</b>

#### NOTE 7: PREMISES, EQUIPMENT AND COMPUTER SOFTWARE

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

31 December	2008			2007		
	Accumulated Cost	depreciation	Net carrying value	Accumulated Cost	depreciation	Net carrying value
Land	13,726	-	13,726	13,726	-	13,726
Buildings	163,186	(36,511)	126,675	154,737	(34,537)	120,200
Equipment	51,037	(35,151)	15,886	60,332	(39,033)	21,299
Computer software	72,941	(32,073)	40,868	86,254	(26,100)	60,154
<b>Total</b>	<b>300,890</b>	<b>(103,735)</b>	<b>197,155</b>	<b>315,049</b>	<b>(99,670)</b>	<b>215,379</b>

31 December	2008	2007
<b>Depreciation</b>		
Buildings (included in property expense)	5,225	4,755
Equipment (included in property expense)	3,565	3,407
Computer hardware and software (included in technology & communication expense)	12,583	7,742
<b>Total depreciation charged to operating expenses</b>	<b>21,373</b>	<b>15,904</b>

#### NOTE 8: GOODWILL AND OTHER INTANGIBLE ASSETS

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

Business segment	Goodwill				
	Barbados	Guernsey	The Bahamas	United Kingdom	Total
Balance as at 31 December 2006	5,220	8,363	1,923	9,512	25,018
Foreign exchange translation adjustment	-	114	-	128	242
Balance as at 31 December 2007	5,220	8,477	1,923	9,640	25,260
Goodwill sold during the year	-	-	(1,032)	-	(1,032)
Goodwill impairment	(5,220)	-	-	-	(5,220)
Foreign exchange translation adjustment	-	(2,250)	-	(2,394)	(4,644)
<b>Balance as at 31 December 2008</b>	<b>-</b>	<b>6,227</b>	<b>891</b>	<b>7,246</b>	<b>14,364</b>



**Customer relationship intangible assets**

31 December	2008			2007		
	Gross carrying amount	Accumulated amortisation	Net carrying amount	Gross carrying amount	Accumulated amortisation	Net carrying amount
Bermuda	8,341	(2,367)	5,974	26,063	(2,003)	24,060
Barbados	6,681	(2,263)	4,418	6,681	(1,816)	4,865
Cayman	1,211	(349)	862	1,211	(268)	943
Guernsey	38,582	(18,127)	20,455	52,504	(21,147)	31,357
The Bahamas	5,090	(1,833)	3,257	7,790	(2,819)	4,971
United Kingdom	18,002	(5,407)	12,595	20,477	(5,443)	15,034
Malta	3,284	(255)	3,029	-	-	-
Hong Kong	7,224	(564)	6,660	-	-	-
<b>Total</b>	<b>88,415</b>	<b>(31,165)</b>	<b>57,250</b>	114,726	(33,496)	81,230

There have been no impairment losses for the years ended 31 December 2008 and 2007, other than as noted above in the Barbados segment. The estimated aggregate amortisation expense for each of the succeeding years until 31 December 2013 is \$7.1 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 2008, the Bank acquired new customer relationships for nil (2007: \$17.7 million) and sold customer relationship having a book value of \$1.2 million. The amortisation expense amounted to \$7.3 million (2007: \$6.9 million) and the foreign exchange translation adjustment decreased the net carrying amount by \$15.5 million (2007: increased by \$0.7 million). During the year, customer relationship intangible assets related to the acquisition of Bentley Reid business units located in Malta and Hong Kong were reclassified out of the Bermuda segment into their respective geographical segments.

**NOTE 9: CUSTOMER DEPOSITS AND DEPOSITS FROM BANKS**
**(a) By Maturity**

31 December	2008			2007		
	Customers	Banks	Total	Customers	Banks	Total
<b>Demand deposits</b>						
Demand deposits - Non-interest bearing	920,866	-	920,866	1,042,062	-	1,042,062
Demand deposits - Interest bearing	5,031,372	71,423	5,102,795	4,869,122	154,769	5,023,891
<b>Sub-total - demand deposits</b>	<b>5,952,238</b>	<b>71,423</b>	<b>6,023,661</b>	5,911,184	154,769	6,065,953
<b>Term deposits</b>						
Term deposits maturing within six months	3,045,722	320,931	3,366,653	4,153,351	147,080	4,300,431
Term deposits maturing between six to twelve months	196,296	2,740	199,036	178,814	4,543	183,357
Term deposits maturing after twelve months	211,919	-	211,919	198,230	-	198,230
<b>Sub-total - term deposits</b>	<b>3,453,937</b>	<b>323,671</b>	<b>3,777,608</b>	4,530,395	151,623	4,682,018
<b>Total</b>	<b>9,406,175</b>	<b>395,094</b>	<b>9,801,269</b>	10,441,579	306,392	10,747,971

**(b) By Type and Location**

31 December	2008			2007		
	Payable on demand	Payable on a fixed date	Total	Payable on demand	Payable on a fixed date	Total
<b>Bermuda</b>						
Customers	2,368,312	1,332,483	3,700,795	2,229,386	1,626,180	3,855,566
Banks	58,566	208,304	266,870	86,562	27,078	113,640
<b>Barbados</b>						
Customers	156,248	75,393	231,641	165,532	60,609	226,141
Banks	-	-	-	2,566	20,549	23,115
<b>Cayman</b>						
Customers	2,216,042	778,153	2,994,195	1,518,295	839,220	2,357,515
Banks	-	110,597	110,597	12,848	98,709	111,557
<b>Guernsey (a)</b>						
Customers	613,989	673,832	1,287,821	962,832	1,143,182	2,106,014
Banks	7,676	-	7,676	44,649	506	45,155
<b>The Bahamas</b>						
Customers	46,907	69,666	116,573	72,393	81,967	154,360
Banks	-	-	-	-	-	-
<b>United Kingdom (a)</b>						
Customers	550,740	524,410	1,075,150	962,746	779,237	1,741,983
Banks	5,181	4,770	9,951	8,144	4,781	12,925
<b>Total Customers</b>	<b>5,952,238</b>	<b>3,453,937</b>	<b>9,406,175</b>	5,911,184	4,530,395	10,441,579
<b>Total Banks</b>	<b>71,423</b>	<b>323,671</b>	<b>395,094</b>	154,769	151,623	306,392
<b>Total</b>	<b>6,023,661</b>	<b>3,777,608</b>	<b>9,801,269</b>	6,065,953	4,682,018	10,747,971

a) The decrease in the reported amounts of customer deposits and deposits from banks in the Guernsey and United Kingdom segments is partly due to movements in foreign exchange translation.

## NOTE 10: EMPLOYEE FUTURE BENEFITS

The Bank maintains trustee pension plans including non-contributory defined benefit plans and a number of defined contribution plans, and provides post-retirement medical benefits to its qualifying retirees. The defined benefit provisions under the pension plans are generally based upon years of service and average salary during the final years of employment. The defined benefit plans are non-contributory and the funding required is provided by the Bank, based upon the advice of an independent actuary.

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 31 December 2008 and 30 November 2007.

	2008		2007	
	Pension plans	Post-retirement medical benefit plan	Pension plans	Post-retirement medical benefit plan
<b>Accumulated benefit obligation at end of year</b>	<b>102,897</b>	<b>-</b>	109,978	-
<b>Change in projected benefit obligation</b>				
Opening projected benefit obligation	120,212	98,152	122,378	106,656
Acquisitions/Change in measurement date	176	764	-	-
Service cost	2,854	3,088	3,529	2,612
Employee contributions	310	-	332	-
Interest cost	7,233	6,811	6,632	6,192
Benefits paid	(4,918)	(1,663)	(4,450)	(1,240)
Settlement of liability	(2,775)	-	(2,969)	-
Actuarial (gain) loss	(218)	12,800	(5,982)	(16,068)
Foreign exchange translation adjustment	(14,884)	-	742	-
<b>Closing projected benefit obligation</b>	<b>107,990</b>	<b>119,952</b>	120,212	98,152
<b>Change in plan assets</b>				
Opening fair value of plan assets	132,007	-	122,729	-
New acquisitions/Change in measurement date	160	-	-	-
Actual return on plan assets	(17,058)	-	6,682	-
Employer contribution	27,999	1,663	8,541	1,240
Employee contributions	310	-	400	-
Benefits paid	(4,918)	(1,663)	(4,450)	(1,240)
Cost of settlement	(35)	-	(2,603)	-
Foreign exchange translation adjustment	(16,530)	-	708	-
<b>Closing fair value of plan assets</b>	<b>121,935</b>	<b>-</b>	132,007	-
<b>Funded status</b>				
Surplus (deficit) of plan assets over projected benefit obligation at measurement date	13,945	(119,952)	11,795	(98,152)
Employer contribution during the period from measurement date to fiscal year end	-	-	167	89
<b>Net asset (liability) recognised</b>	<b>13,945</b>	<b>(119,952)</b>	11,962	(98,063)
<b>Amounts recognised in the balance sheet consist of:</b>				
Prepaid benefit cost included in other assets	14,031	-	11,962	-
Accrued pension benefit cost included in employee future benefits liability	(86)	(119,952)	-	(98,063)
<b>Net asset (liability) recognised in the balance sheet</b>	<b>13,945</b>	<b>(119,952)</b>	11,962	(98,063)
<b>Amounts recognised in accumulated other comprehensive loss consist of:</b>				
Net actuarial (loss) gain	(19,272)	(32,616)	3,542	(21,141)
Past service cost	(32)	-	(89)	-
<b>Net amount recognised in accumulated other comprehensive loss</b>	<b>(19,304)</b>	<b>(32,616)</b>	3,453	(21,141)

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

	2008		2007	
	Pension plans	Post-retirement medical benefit plan	Pension plans	Post-retirement medical benefit plan
<b>Annual benefit expense</b>				
Service cost	2,854	3,088	3,529	2,612
Interest cost	7,233	6,811	6,632	6,192
Expected return on plan assets	(8,739)	N/A	(8,191)	N/A
Amortisation of past service cost	41	-	40	-
Amortisation of net actuarial loss	11	1,218	578	3,200
Loss (gain) on settlement	3	-	(366)	-
Defined benefit expense	1,403	11,117	2,222	12,004
Defined contribution expense	6,210	-	5,281	-
<b>Total benefit expense</b>	<b>7,613</b>	<b>11,117</b>	7,503	12,004
<b>Other changes recognised in other comprehensive loss</b>				
Net loss arising during the period	(22,680)	(12,693)	3,692	16,068
Amortisation of past service cost	29	-	40	-
Amortisation of net actuarial (gain) loss	(22)	1,218	578	3,200
<b>Total changes recognised in other comprehensive loss</b>	<b>(22,673)</b>	<b>(11,475)</b>	4,310	19,268

The estimated portions of the net actuarial loss and past service cost for the pension plans that will be amortised from accumulated other comprehensive loss into benefit expense over the next fiscal year are \$3.0 million and nil respectively. The estimated portion of the net actuarial loss for the post-retirement medical benefit plan that will be amortised from accumulated other comprehensive loss into benefit expense over the next fiscal year is \$1.6 million.

	2008		2007	
	Pension plans	Post-retirement medical benefit plan	Pension plans	Post-retirement medical benefit plan
<b>31 December</b>				
<b>Actuarial assumptions used to determine annual benefit expense</b>				
Weighted average discount rate	6.25%	6.70%	5.35%	5.75%
Weighted average rate of compensation increases	4.00%	N/A	3.65%	N/A
Weighted average expected long-term rate of return on plan assets	6.75%	N/A	6.55%	N/A
Weighted average annual medical cost increase rate	N/A	9% to 5% in 2013	N/A	10% to 5% in 2013
<b>Actuarial assumptions used to determine benefit obligations at end of year</b>				
Weighted average discount rate	6.15%	6.10%	6.25%	6.70%
Weighted average rate of compensation increases	3.70%	N/A	4.00%	N/A
Weighted average annual medical cost increase rate	N/A	8% to 5% in 2013	N/A	9% to 5% in 2013

For 2008, 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 \$2.3 million increase (2007: \$1.9 million) and a \$1.8 million decrease (2007: \$1.5 million), respectively, and on the benefit obligation a \$24.9 million increase (2007: \$17.6 million) and a \$19.4 million decrease (2007: \$14.3 million), respectively.

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

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

31 December	2008		2007	
	Actual allocation	Target allocation	Actual allocation	Target allocation
<b>Asset category</b>				
Equity securities (including equity mutual funds)	32%	46%	46%	46%
Debt securities (including debt mutual funds)	60%	53%	44%	52%
Other	8%	1%	10%	2%
<b>Total</b>	<b>100%</b>	<b>100%</b>	100%	100%

At 31 December 2008, 42.3% (2007: 38.1%) 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 2008, 2.2% (2007: 3.1%) of the plans' 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 2009 Bank contribution to, and estimated benefit payments for the next ten years under, the pension and post-retirement medical benefit plans are as follows:

	Pension plans	Post-retirement medical benefit plan
Estimated Bank contributions for 2009	2,700	3,400
Estimated benefit payments by year:		
2009	3,900	3,400
2010	4,600	3,800
2011	4,800	4,200
2012	5,000	4,500
2013	5,200	4,800
2014 - 2018	29,700	30,000

The projected benefit obligation and fair value of plan assets for pension plans with projected benefit obligations in excess of plan assets were \$24.2 million and \$21.4 million as at 31 December 2008 (nil as at 31 December 2007).

As at 31 December 2008 and 2007 there were no pension plans that had an excess of accumulated benefit obligations over the plan assets.

#### NOTE 11: COMMITMENTS, CREDIT RELATED ARRANGEMENTS AND CONTINGENCIES

##### Commitments

The Bank was committed to expenditures under contract for software development, sourcing and long-term leases of nil, \$163.0 million and \$29.2 million respectively, as at 31 December 2008 (2007: \$12.6 million, nil and \$36.0 million respectively). Rental expense for premises leased on a long-term basis for the year ended 31 December 2008 amounted to \$6.4 million (2007: \$7.9 million).

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

Year	
2009	41,961
2010	29,196
2011	23,558
2012	22,310
2013	21,355
2014 & thereafter	53,846

##### Credit Related Arrangements

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

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

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

31 December	2008			2007		
	Gross	Collateral	Net	Gross	Collateral	Net
Standby letters of credit	463,868	317,018	146,850	407,656	350,983	56,673
Letters of guarantee	14,230	3,311	10,919	18,271	11,810	6,461
<b>Total</b>	<b>478,098</b>	<b>320,329</b>	<b>157,769</b>	425,927	362,793	63,134

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

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

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

31 December	2008	2007
Commitments to extend credit	559,916	1,245,604
Documentary and commercial letters of credit	2,938	2,381
<b>Total</b>	<b>562,854</b>	1,247,985

The Bank has a facility by one of its custodians, whereby the Bank may offer up to US\$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 to set-off against securities held of 110% of the utilised facility. At 31 December 2008, \$102.1 million (2007: \$97.5 million) 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, with the following exception: the Bank has an interest in interpleader proceedings in New York Southern Federal District Court concerning the priority of payments relating to an investment security in which the Bank has an interest in an amount of \$13.5 million, which is the carrying value. Given the significant uncertainty surrounding this matter, it is reasonably possible that a loss will arise. However due to the significant uncertainty surrounding this matter an estimate of the potential loss in carrying value cannot be determined and no provision has been made.

#### NOTE 12: INTEREST INCOME

##### Loans

The following table presents the components of loan interest income:

Year ended 31 December	2008	2007
Mortgages	100,790	144,240
Other loans	157,765	134,190
	<b>258,555</b>	278,430
Amortisation of loan origination fees (net of amortised costs)	6,015	6,265
<b>Total loan interest income</b>	<b>264,570</b>	284,695
<b>Balance of unamortised loan fees as at 31 December</b>	<b>11,021</b>	13,723

**NOTE 13: SEGMENTED INFORMATION**

**(a) Operating Segments**

For management reporting purposes, the operations of the Bank are grouped into the following 11 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, Switzerland, The Bahamas, United Kingdom, Malta 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 community, commercial and private banking services. Retail services are offered to individuals and small to medium sized businesses through five branch locations and through telephone banking, internet banking, Automated Teller Machines (ATMs) and debit cards. Retail services include deposit services, consumer and mortgage lending, credit cards and personal insurance products. 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.

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 Fund Services (Bermuda) Limited (now part of Butterfield Fulcrum Group) which was sold during the year and wherein the Bank retains a 40% interest (on a fully diluted basis), which provides valuation, accounting, corporate and shareholder services, and Butterfield Trust (Bermuda) Limited which provides trust, estate, company management and custody 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, 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, investment and pension fund administration services and wealth management and fiduciary services.

The Switzerland segment provides wealth management and fiduciary 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 Malta and Hong Kong segments provide wealth management and fiduciary services.

Operating segment information follows:

31 December	2008	2007
<b>Total Assets</b>		
<b>Bermuda</b>		
Community Banking	5,355,488	5,414,903
Wealth Management & Fiduciary Services and Investment & Pension Fund Administration	25,963	38,680
Real Estate	86,662	101,913
<b>Total Bermuda</b>	<b>5,468,113</b>	5,555,496
Barbados	264,521	277,297
Cayman	3,328,712	2,729,334
Guernsey	1,448,609	2,368,565
Switzerland	984	537
The Bahamas	155,260	181,671
United Kingdom	1,321,678	1,999,093
Malta	3,169	-
Hong Kong	8,633	4,271
<b>Total overseas</b>	<b>6,531,566</b>	7,560,768
Less: inter-segment eliminations	(1,087,835)	(1,205,344)
<b>Total</b>	<b>10,911,844</b>	11,910,920

**Business Area Analysis**

Year ended 31 December 2008	Net interest income		Allowance for credit losses	Non-interest income	Revenue before gains and losses	Total expenses	Net Income before gains and losses and central allocations	Gains and losses	Central allocations*	Net income
	Customer	Intersegment								
<b>Bermuda</b>										
Community Banking	160,975	(24,819)	(1,838)	45,081	179,399	147,870	31,529	(160,935)	22,335	(107,071)
Wealth Management & Fiduciary Services and Investment & Pension Fund Administration	-	86	-	72,678	72,764	46,827	25,937	-	(23,860)	2,077
Real Estate	-	(1,047)	-	2,255	1,208	10,751	(9,543)	-	9,543	-
<b>Sub-total Bermuda</b>	<b>160,975</b>	<b>(25,780)</b>	<b>(1,838)</b>	<b>120,014</b>	<b>253,371</b>	<b>205,448</b>	<b>47,923</b>	<b>(160,935)</b>	<b>8,018</b>	<b>(104,994)</b>
Barbados	9,111	533	(292)	3,629	12,981	11,522	1,459	1,950	(216)	3,193
Cayman**	32,014	17,612	(639)	47,172	96,159	61,905	34,254	47,585	(4,304)	77,535
Guernsey	16,999	4,936	-	37,270	59,205	40,044	19,161	131	(2,078)	17,214
Switzerland	4	-	-	270	274	3,595	(3,321)	-	-	(3,321)
The Bahamas	1,894	1,706	-	7,534	11,134	8,779	2,355	-	(436)	1,919
United Kingdom	33,414	(5,773)	(276)	11,768	39,133	29,067	10,066	2,218	(612)	11,672
Malta	34	-	-	1,655	1,689	1,355	334	-	(116)	218
Hong Kong	36	-	-	3,903	3,939	2,280	1,659	-	(256)	1,403
<b>Sub-total overseas</b>	<b>93,506</b>	<b>19,014</b>	<b>(1,207)</b>	<b>113,201</b>	<b>224,514</b>	<b>158,547</b>	<b>65,967</b>	<b>51,884</b>	<b>(8,018)</b>	<b>109,833</b>
<b>Total before eliminations</b>	<b>254,481</b>	<b>(6,766)</b>	<b>(3,045)</b>	<b>233,215</b>	<b>477,885</b>	<b>363,995</b>	<b>113,890</b>	<b>(109,051)</b>	<b>-</b>	<b>4,839</b>
Less: inter-segment eliminations (principally rent and management fees)	-	6,766	-	(20,274)	(13,508)	(13,508)	-	-	-	-
<b>Total</b>	<b>254,481</b>	<b>-</b>	<b>(3,045)</b>	<b>212,941</b>	<b>464,377</b>	<b>350,487</b>	<b>113,890</b>	<b>(109,051)</b>	<b>-</b>	<b>4,839</b>

\*This includes the allocation of property costs to the Bermuda business lines. In addition, it includes the charge out of the central costs across the Group.

\*\* The net gain of \$47.6 million relates to the gain on sale of Butterfield Fund Services (Cayman) Limited offset by other-than-temporary impairment of a collateralised mortgage obligation and a realised loss related to a corporate debt security.

Year ended 31 December 2007	Net interest income		Allowance for credit losses	Non-interest income	Revenue before gains and losses	Total expenses	Net Income before gains and losses and central allocations	Gains and losses	Central allocations*	Net income
	Customer	Intersegment								
<b>Bermuda</b>										
Community Banking	146,817	(22,048)	(2,332)	39,017	161,454	120,908	40,546	(1,172)	18,246	57,620
Wealth Management & Fiduciary Services and Investment & Pension Fund Administration	-	526	-	82,942	83,468	47,563	35,905	(20)	(18,587)	17,298
Real Estate	-	(1,268)	-	2,387	1,119	10,221	(9,102)	-	9,102	-
<b>Sub-total Bermuda</b>	<b>146,817</b>	<b>(22,790)</b>	<b>(2,332)</b>	<b>124,346</b>	<b>246,041</b>	<b>178,692</b>	<b>67,349</b>	<b>(1,192)</b>	<b>8,761</b>	<b>74,918</b>
Barbados	7,323	1,039	42	3,517	11,921	11,983	(62)	233	(30)	141
Cayman	48,603	13,808	352	51,793	114,556	57,981	56,575	654	(6,549)	50,680
Guernsey	18,589	4,514	-	41,498	64,601	48,380	16,221	(3)	(1,640)	14,578
Switzerland	-	(35)	-	241	206	1,296	(1,090)	-	-	(1,090)
The Bahamas	418	2,981	-	8,654	12,053	8,987	3,066	-	(292)	2,774
United Kingdom	30,850	(5,248)	(45)	6,835	32,392	29,288	3,104	(28)	(250)	2,826
Hong Kong	-	-	-	1,168	1,168	-	1,168	-	-	1,168
<b>Sub-total overseas</b>	<b>105,783</b>	<b>17,059</b>	<b>349</b>	<b>113,706</b>	<b>236,897</b>	<b>157,915</b>	<b>78,982</b>	<b>856</b>	<b>(8,761)</b>	<b>71,077</b>
<b>Total before eliminations</b>	<b>252,600</b>	<b>(5,731)</b>	<b>(1,983)</b>	<b>238,052</b>	<b>482,938</b>	<b>336,607</b>	<b>146,331</b>	<b>(336)</b>	<b>-</b>	<b>145,995</b>
Less: inter-segment eliminations (principally rent and management fees)	-	5,731	-	(18,370)	(12,639)	(12,639)	-	-	-	-
<b>Total</b>	<b>252,600</b>	<b>-</b>	<b>(1,983)</b>	<b>219,682</b>	<b>470,299</b>	<b>323,968</b>	<b>146,331</b>	<b>(336)</b>	<b>-</b>	<b>145,995</b>

For the year ended 31 December 2008, included within other expenses are the following income tax expense amounts: Guernsey \$0.9 million (2007: \$4.9 million), United Kingdom \$2.0 million (2007: \$2.0 million) and Barbados \$0.1 million (2007: \$0.1 million). 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.

The Bank provides credit enhancement to a related party, namely BMMFL. Under the credit enhancement agreement (the Agreement), the Bank is committed to compensate BMMFL subject to a maximum of 30% of BMMFL's holding of a specific identified investment should that security have a fair value less than BMMFL's carrying value and BMMFL is required to draw down on the obligation in order to retain its credit rating from the rating agency. The decision by the rating agency with regard to the rating requirements is outside the control of the Bank. In consideration, the Bank charged a fee of \$4.5 million during the six month period covered by the Agreement ending 15 January 2009. As at 31 December 2008 the Bank has recognised a derivative liability for the maximum value of the credit derivative which is \$44.4 million. The Agreement may be terminated without being drawn down before its term expires in certain circumstances, including if the underlying asset backed commercial paper is sold or restructured into securities. On 16 January 2009 the Agreement was extended for three months.

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 loans to floating-rate loans, and convert fixed-rate deposits to floating-rate deposits. For the years ended 31 December 2007 and 2008, no gain or losses were realised from ineffective portion of fair value hedges. As of 31 December 2008 the Bank has recorded the fair value of derivative instrument assets of negative \$26.7 million (2007: positive \$0.1 million) in other assets and derivative instrument liabilities of negative \$0.3 million (2007: positive \$5.1 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 loss 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 2008 and 2007, there was no hedge ineffectiveness related to cash flow hedges. As of 31 December 2008 and 2007 there was no deferred net gains or losses on derivative instruments accumulated in other comprehensive income that 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 nil (2007: nil months). As of 31 December 2008, the Bank has recorded the fair value of derivative instrument of nil (2007: \$0.1 million) in other liabilities.

#### (c) 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.

31 December	2008			2007		
	Trading	ALM	Total	Trading	ALM	Total
<b>Interest rate contracts</b>						
Interest rate swaps	102,143	222,265	324,408	40,000	407,676	447,676
Interest rate caps and currency options	35,021	-	35,021	38,686	-	38,686
<b>Sub-total</b>	<b>137,164</b>	<b>222,265</b>	<b>359,429</b>	<b>78,686</b>	<b>407,676</b>	<b>486,362</b>
<b>Other derivatives</b>						
Spot and forward foreign exchange	3,597,529	-	3,597,529	6,626,278	-	6,626,278
Credit derivative	44,400	-	44,400	50,000	-	50,000
Currency options	-	-	-	-	-	-
<b>Sub-total</b>	<b>3,641,929</b>	<b>-</b>	<b>3,641,929</b>	<b>6,676,278</b>	<b>-</b>	<b>6,676,278</b>
<b>Total notional amount of financial derivatives outstanding</b>	<b>3,779,093</b>	<b>222,265</b>	<b>4,001,358</b>	<b>6,754,964</b>	<b>407,676</b>	<b>7,162,640</b>

Included in the notional amounts for fair value hedges using interest rate swaps for 2008, are \$210.0 million (2007: \$116.0 million) pertaining to specific loans, nil (2007: \$125.0 million) pertaining to subordinated debt, and \$12.3 million (2007: \$166.6 million) pertaining to fixed-rate deposits.

#### (d) 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.

31 December	2008			2007		
	Positive	Negative	Net	Positive	Negative	Net
<b>Derivative financial instruments</b>						
Interest rate swaps	122	27,223	(27,101)	1,085	5,884	(4,799)
Interest rate caps and currency options	383	383	-	1,039	1,039	-
Spot and forward foreign exchange	68,440	57,208	11,232	71,692	77,475	(5,783)
Credit derivative	-	44,400	(44,400)	-	6,250	(6,250)
<b>Total fair value</b>	<b>68,945</b>	<b>129,214</b>	<b>(60,269)</b>	<b>73,816</b>	<b>90,648</b>	<b>(16,832)</b>

#### (e) 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 2008	Within	6 to 12	1 to 3	3 to 5	After	Total
	6 months	months	years	years	5 years	
<b>Interest rate contracts</b>						
Interest rate swaps	110,183	1,800	56,573	50,875	104,977	324,408
Interest rate caps and currency options	-	-	-	35,021	-	35,021
<b>Sub-total</b>	<b>110,183</b>	<b>1,800</b>	<b>56,573</b>	<b>85,896</b>	<b>104,977</b>	<b>359,429</b>
<b>Other derivatives</b>						
Spot and forward foreign exchange	3,541,235	50,749	5,545	-	-	3,597,529
Credit derivative	44,400	-	-	-	-	44,400
<b>Sub-total</b>	<b>3,585,635</b>	<b>50,749</b>	<b>5,545</b>	<b>-</b>	<b>-</b>	<b>3,641,929</b>
<b>Total notional amount by remaining maturity</b>	<b>3,695,818</b>	<b>52,549</b>	<b>62,118</b>	<b>85,896</b>	<b>104,977</b>	<b>4,001,358</b>

31 December 2007	Within 6 months	6 to 12 months	1 to 3 years	3 to 5 years	After 5 years	Total
<b>Interest rate contracts</b>						
Interest rate swaps	254,582	18,333	84,597	17,073	73,090	447,675
Interest rate caps and currency options	3,970	-	-	34,716	-	38,686
<b>Sub-total</b>	<b>258,552</b>	<b>18,333</b>	<b>84,597</b>	<b>51,789</b>	<b>73,090</b>	<b>486,361</b>
<b>Other derivatives</b>						
Spot and forward foreign exchange	6,531,123	84,210	10,946	-	-	6,626,279
Credit derivative	50,000	-	-	-	-	50,000
<b>Sub-total</b>	<b>6,581,123</b>	<b>84,210</b>	<b>10,946</b>	<b>-</b>	<b>-</b>	<b>6,676,279</b>
<b>Total notional amount by remaining maturity</b>	<b>6,839,675</b>	<b>102,543</b>	<b>95,543</b>	<b>51,789</b>	<b>73,090</b>	<b>7,162,640</b>

#### (f) 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.

31 December	2008			2007		
	Trading	ALM	Total value	Trading	ALM	Total value
<b>Interest rate contracts</b>						
Interest rate swaps	-	122	122	-	1,085	1,085
Interest rate caps and currency options	383	-	383	1,039	-	1,039
<b>Sub-total</b>	<b>383</b>	<b>122</b>	<b>505</b>	<b>1,039</b>	<b>1,085</b>	<b>2,124</b>
<b>Other derivatives</b>						
Spot and forward foreign exchange	68,440	-	68,440	71,692	-	71,692
Credit derivative	-	-	-	-	-	-
Currency options	-	-	-	-	-	-
<b>Sub-total</b>	<b>68,440</b>	<b>-</b>	<b>68,440</b>	<b>71,692</b>	<b>-</b>	<b>71,692</b>
<b>Total replacement cost</b>	<b>68,823</b>	<b>122</b>	<b>68,945</b>	<b>72,731</b>	<b>1,085</b>	<b>73,816</b>

#### NOTE 15: FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the carrying value and fair value of financial assets and liabilities under SFAS No. 107 Disclosures About Fair Value of Financial Instruments (SFAS 107) and SFAS No. 157 Fair Value Measurements (SFAS 157). Accordingly, certain amounts which are not considered financial instruments are excluded from the table. For investments with an indicator of impairment, management has 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, Management believes it will recover the full carrying value of the securities. 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, Management may reassess whether a market value below carrying value represents an other-than-temporary impairment.

During 2008, Management determined that investments with a carrying value of \$103.8 million were other-than-temporarily impaired and consequently re-measured those investments at their fair value of \$7.6 million. The determination of fair value was based on an unadjusted bid price determined to be Level 2 in the pricing hierarchy (significant other observable inputs).

#### a) Items that are recognised at fair value on a recurring basis:

31 December	2008				2007			
	Fair value determination				Fair value determination			
	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Total carrying value / fair value	Quoted prices in active markets for identical assets	Significant other observable inputs	Significant unobservable inputs	Total carrying value / fair value
<b>Financial assets</b>								
Investments								
Trading	27,868	7,862	12,599	48,329	35,416	10,608	12,510	58,534
Available for sale	-	579,799	-	579,799	-	932,238	-	932,238
Other assets - Derivatives	-	68,945	-	68,945	-	73,816	-	73,816
<b>Financial liabilities</b>								
Other liabilities - Derivatives	-	129,214	-	129,214	-	90,648	-	90,648

#### b) Items measured on a recurring basis using significant unobservable inputs:

31 December	2008		2007	
	Trading investment		Trading investment	
Carrying value at beginning of year	12,510		7,395	
Realised and unrealised gains recognised in net income	89		5,115	
Carrying value at end of year	12,599		12,510	

The trading investment measured using significant unobservable inputs consists of shares of a non-redeemable private equity fund investing primarily in the real estate sector (the "Fund"). The Fund's adviser retains the services of an independent valuation company at each reporting date. Due to the nature of the properties held by the Fund and lack of comparable market data, the fair values of investment properties are estimated based on the income capitalisation method, where the value is estimated from the expected future benefits to be generated by the property in the form of income streams from renting out of premises. The method considers net income generated by comparable property, capitalised to determine the value for the subject property.

The change in unrealised gains or losses in shares of the Fund are reported under Realised / unrealised (losses) gains on trading securities in the Consolidated Statement of Income.

#### c) Items other than those recognised at fair value on a recurring basis:

31 December 2008	2008			2007		
	Carrying value	Fair value	Appreciation/ (depreciation)	Carrying value	Fair value	Appreciation/ (depreciation)
<b>Financial assets</b>						
Cash and deposits with banks	2,221,390	2,221,390	-	2,517,012	2,517,012	-
Investments held to maturity	3,195,951	2,758,622	(437,329)	3,754,217	3,591,980	(162,237)
Loans						
Commercial, net of allowance for credit losses	2,205,790	2,200,051	(5,739)	2,228,264	2,225,280	(2,984)
Consumer, net of allowance for credit losses	2,212,487	2,212,591	104	1,896,500	1,896,965	465
<b>Financial liabilities</b>						
Customer deposits						
Demand deposits	5,952,238	5,952,238	-	5,911,184	5,911,184	-
Term deposits	3,453,937	3,464,756	(10,819)	4,530,395	4,526,335	4,060
Deposits from banks	395,094	395,094	-	306,392	306,392	-
Subordinated capital	282,296	256,751	25,545	284,191	290,993	(6,802)

#### NOTE 16: INTEREST RATE RISK

The following table sets out the assets, liabilities and shareholders' equity and off-balance sheet instruments on the date of the earlier of contractual maturity 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.

31 December 2008 (in \$ millions)	Earlier of contractual maturity or repricing date						Total
	Within 3 months	3 to 6 months	6 to 12 months	1 to 5 years	After 5 years	Non-interest bearing funds	
<b>Assets</b>							
Cash and deposits with banks	2,036	20	3			162	2,221
Investments	3,209	181	73	135	38	188	3,824
Loans	3,373	165	115	408	333	24	4,418
Premises, equipment and computer software	-	-	-	-	-	197	197
Other assets	-	-	-	-	-	252	252
<b>Total assets</b>	<b>8,618</b>	<b>366</b>	<b>191</b>	<b>543</b>	<b>371</b>	<b>823</b>	<b>10,912</b>
<b>Liabilities and shareholders' equity</b>							
Shareholders' equity	-	-	-	-	-	518	518
Deposits	8,171	299	199	206	5	921	9,801
Other liabilities	-	-	-	-	-	311	311
Subordinated capital	-	-	-	197	85	-	282
<b>Total liabilities and shareholders' equity</b>	<b>8,171</b>	<b>299</b>	<b>199</b>	<b>403</b>	<b>90</b>	<b>1,750</b>	<b>10,912</b>
<b>Interest rate swaps</b>	<b>212</b>	<b>(9)</b>	<b>9</b>	<b>(107)</b>	<b>(105)</b>	<b>-</b>	<b>-</b>
Interest rate sensitivity gap	659	58	1	33	176	(927)	-
Cumulative interest rate sensitivity gap	659	717	718	751	927	-	-

31 December 2007 (in \$ millions)	Earlier of contractual maturity or repricing date						Total
	Within 3 months	3 to 6 months	6 to 12 months	1 to 5 years	After 5 years	Non-interest bearing funds	
<b>Assets</b>							
Cash and deposits with banks	2,284	43	64	-	-	126	2,517
Investments	3,987	301	236	126	47	48	4,745
Loans (a)	3,478	215	52	175	209	(4)	4,125
Premises, equipment and computer software	-	-	-	-	-	215	215
Other assets	-	-	-	-	-	309	309
<b>Total assets</b>	<b>9,749</b>	<b>559</b>	<b>352</b>	<b>301</b>	<b>256</b>	<b>694</b>	<b>11,911</b>
<b>Liabilities and shareholders' equity</b>							
Shareholders' equity	-	-	-	-	-	629	629
Deposits (a)	7,807	1,517	183	186	13	1,042	10,748
Other liabilities	-	-	-	-	-	250	250
Subordinated capital (a)	125	-	-	100	60	(1)	284
<b>Total liabilities and shareholders' equity</b>	<b>7,932</b>	<b>1,517</b>	<b>183</b>	<b>286</b>	<b>73</b>	<b>1,920</b>	<b>11,911</b>
Interest rate sensitivity gap	1,817	(958)	169	15	183	(1,226)	-
Cumulative interest rate sensitivity gap	1,817	859	1,028	1,043	1,226	-	-

(a) Principal amounts of interest rate swaps are included within the lines items to which they relate.

#### NOTE 17: SUBORDINATED CAPITAL

On 28 May 2003, the Bank issued US \$125 million of Subordinated Lower Tier II capital notes. The notes were issued at par and in two tranches, namely US \$78 million in Series A notes due 2013 and US \$47 million in Series B notes due 2018. The issuance was by way of private placement with US institutional investors. The notes are listed on the Bermuda Stock Exchange (BSX) in the specialist debt securities category. Part proceeds of the issue were used to repay the entire amount of the US \$75 million outstanding subordinated notes redeemed in July 2003.

The notes issued under Series A paid a fixed coupon of 3.94% until 27 May 2008 when it was redeemed in whole by the Bank. The Series B notes pays a fixed coupon of 5.15% until 27 May 2013 when they become redeemable in whole at the Bank's option. The Series B notes were priced at a spread of 1.35% over the 10-year US Treasury yield.

On 2 April 2004, in conjunction with the acquisition of Leopold Joseph, the Bank assumed a subordinated debt of £5 million which is included in the balance sheet in the amount of \$9.9 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 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.

On 27 May 2008, the Bank issued US \$78 million of Subordinated Lower Tier II capital notes. The notes were issued at par and in two tranches, namely US \$53 million in Series A notes due 2018 and US \$25 million in Series B notes due 2023. The issuance was by way of private placement with US institutional investors. The notes are listed on the Bermuda Stock Exchange (BSX) in the specialist debt securities category. The proceeds of the issue were used to repay the entire amount of the US \$78 million outstanding subordinated notes redeemed in May 2008.

The notes issued under Series A pays a fixed coupon of 7.59% until 27 May 2013 when they become redeemable in whole at the option of the Bank. The Series B notes pays a fixed coupon of 8.44% until 27 May 2018 when they also become redeemable in whole at the Bank's option. The Series A notes were priced at a spread of 4.34% over the 5-year US Treasury yield and the Series B notes were priced at a spread of 4.51% over the 10-year US Treasury yield.

Interest capitalised in accordance with SFAS 34 during the year amounted to \$1.9 million (2007: \$1.7 million) and is excluded from interest expense 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 2008:

	Within 1 year	1 to 5 years	After 5 years	Carrying value	
<b>Subordinated capital</b>					
<b>Bermuda</b>					
2003 issuance - Series B	Fixed-rate	2,421	9,284	54,252	47,000
2005 issuance - Series A	Fixed-rate	4,329	11,711	93,964	90,000
2005 issuance - Series B	Fixed-rate	3,066	12,264	75,502	60,000
2008 issuance - Series A	Fixed-rate	4,023	14,462	56,410	53,000
2008 issuance - Series B	Fixed-rate	2,210	8,840	36,733	25,000
Subsidiary	Fixed-rate	678	2,821	10,111	7,296
<b>Total</b>		<b>16,727</b>	<b>59,382</b>	<b>326,972</b>	<b>282,296</b>

#### NOTE 18: EARNINGS PER SHARE

Earnings per share has been calculated using the weighted average number of common shares outstanding during the year after deduction of the shares held as treasury stock and adjusted for the stock dividend and the stock split declared during the years ended 31 December 2008 and 2007 (see also Note 23). The dilutive effect of share-based compensation plans was calculated using the treasury stock method, whereby the proceeds received from the exercise of share-based awards are assumed to be used to repurchase outstanding shares, using the average market price of the Bank's shares for the period.

31 December	2008	2007
<b>Basic earnings per share</b>		
Net income for the year	4,839	145,995
Weighted average number of common shares issued (in thousands)	98,400	98,465
Weighted average number of common shares held as treasury stock (in thousands)	(6,051)	(5,207)
Adjusted weighted average number of common shares (in thousands)	92,349	93,258
	0.05	1.56
<b>31 December</b>	<b>2008</b>	<b>2007</b>
<b>Diluted earnings per share</b>		
Net income for the year	4,839	145,995
Weighted average number of common shares issued (in thousands)	98,400	98,465
Weighted average number of common shares held as treasury stock (in thousands)	(6,051)	(5,207)
Stock options (in thousands)	1,274	2,351
Adjusted weighted average number of diluted common shares (in thousands)	93,623	95,609
	0.05	1.53

## NOTE 19: SHARE-BASED PAYMENT

As at 31 December 2008, the Bank has three share-based compensation plans, which are described below. The compensation cost that has been charged against net income for those plans for the year ended 31 December 2008 was \$6.0 million (2007: \$5.4 million). The total income tax benefit recognised in the income statement for share-based compensation arrangements for the year ended 31 December 2008 was \$0.2 million (2007: \$0.1 million).

### 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 executive officers 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. Option exercise prices are stated and payable in Bermuda dollars. 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 Board of Directors of the Bank has established at 9,000,000 the current maximum number of common shares which may be issued or transferred by the Stock Option Trust pursuant to exercise of options.

At 31 December 2008, the Bank held as treasury stock 6,473,180 common shares (2007: 4,903,324) that can be used to satisfy the Bank's obligations with respect to the Stock Option Plan.

Directors' and Executive Officers' Stock Option Plan	2008				2007	
	Number of shares transferable upon exercise (thousands)	Weighted average exercise price (\$)	Weighted average life remaining (years)	Aggregate intrinsic value (\$)	Number of shares transferable upon exercise (thousands)	Weighted average exercise price (\$)
31 December						
Outstanding at beginning of year	1,399	12.91			542	30.96
Granted (prior to 2007 stock split)	-	-			80	58.25
Exercised (prior to 2007 stock split)	-	-			(75)	19.89
Stock split	-	-			1,093	12.16
Stock dividend granted	170	12.46			-	-
Granted (after 2007 stock split)	320	15.76			-	-
Exercised (after 2007 stock split)	-	-			(241)	7.80
<b>Outstanding at end of year</b>	<b>1,889</b>	<b>12.48</b>	<b>6.48</b>	<b>1,630</b>	<b>1,399</b>	<b>12.91</b>
<b>Vested and exercisable at end of year</b>	<b>1,126</b>	<b>10.34</b>	<b>5.30</b>	<b>1,622</b>	<b>769</b>	<b>10.32</b>

Employees' Stock Option Plan	2008				2007	
	Number of shares transferable upon exercise (thousands)	Weighted average exercise price (\$)	Weighted average life remaining (years)	Aggregate intrinsic value (\$)	Number of shares transferable upon exercise (thousands)	Weighted average exercise price (\$)
31 December						
Outstanding at beginning of year	5,175	14.78			1,706	34.87
Granted (prior to 2007 stock split)	-	-			564	58.25
Exercised (prior to 2007 stock split)	-	-			(291)	27.03
Forfeited / cancelled (prior to 2007 stock split)	-	-			(34)	15.56
Stock split	-	-			3,888	14.24
Stock dividend granted	722	14.15			-	-
Granted (after 2007 stock split)	2,181	15.73			6	20.50
Exercised (after 2007 stock split)	(318)	8.90			(576)	9.08
Forfeited / cancelled (after 2007 stock split)	(250)	-			(88)	16.59
<b>Outstanding at end of year</b>	<b>7,510</b>	<b>14.27</b>	<b>7.41</b>	<b>2,613</b>	<b>5,175</b>	<b>14.78</b>
<b>Vested and exercisable at end of year</b>	<b>3,334</b>	<b>12.27</b>	<b>6.21</b>	<b>2,479</b>	<b>1,836</b>	<b>11.05</b>

The weighted average fair value of stock options granted in the year ended 31 December 2008 was \$1.19 per stock option (2007: \$6.54), calculated using the Black-Scholes-Merton option-pricing model with the following weighted average assumptions:

Year Ended 31 December	2008	2007
Projected dividend yield	3.50%	3.70%
Risk-free interest rate	2.70%	4.80%
Projected volatility	12%	14%
Expected life (years)	5.0	5.0

The projected dividend yield and volatility are based on the historical dividends paid and trading prices of the Bank's common shares. The risk-free interest rate for periods within the expected life of the option is based on the US Treasuries yield curve in effect at the time of grant. The Bank uses historical data to estimate expected option life and employee termination rates; separate groups of employees that have similar historical exercise behaviour are considered separately for valuation purposes.

The compensation cost related to the Plan that has been charged against the income for the year ended 31 December 2008 was \$3.6 million (2007: \$2.9 million). The total intrinsic value of options exercised during the year ended 31 December 2008 was \$2.2 million (2007: \$24.2 million).

As at 31 December 2008, there was \$2.5 million of total unrecognised compensation cost related to non-vested options granted under the Plan. That cost is expected to be recognised over a weighted average period of 2.3 years.

### Deferred Incentive Plan

Under its Deferred Incentive Plan as approved by the Board of Directors, the Bank grants restricted common shares to selected members of the management team. Shares are granted fully vested and are affected by transfer restrictions which are lifted at a rate of 33 percent at the end of each year for three years. The fair value of each restricted common share granted under the Deferred Incentive Plan was estimated based on the grant date market price of the Bank's common shares discounted by 25% for their transfer restrictions. The discount for transfer restrictions was based, among other factors, on published restricted stock studies. During the year ended 31 December 2008, 127,812 restricted shares were granted (2007: 35,442). The fair value of common shares granted during the year ended 31 December 2008 was \$1.7 million (2007: \$1.5 million).

### Executive Long-Term Incentive Restricted Shares Plan

The purpose of the Executive Long-Term Incentive Restricted Share Plan is to provide to selected executives of the Bank and certain subsidiaries of the Bank compensation opportunities that are compatible with shareholder interests that will encourage share ownership and that will enhance the Bank's ability to retain key executives. Under its Executive Long-Term Incentive Restricted Share Plan, the Bank grants restricted shares to selected members of the management team. Shares are granted unvested and vest at a rate of 25 percent at the end of each year for four years. In certain circumstances, including retirement, shares vest on an accelerated basis and vesting may depend on the Bank's performance. The fair value of each common share granted under the Executive Long-Term Incentive Restricted Share Plan was based on the grant date market price of the Bank's common shares. During the year ended 31 December 2008, 88,112 shares were granted (2007: 23,532 shares). The fair value of common shares granted during the year ended 31 December 2008 was \$1.4 million (2007: \$1.4 million).

As at 31 December 2008, there was \$1.0 million of total unrecognised compensation cost related to non-vested shares granted under the Plan. That cost is expected to be recognised over a weighted average period of 2.6 years.

## NOTE 20: SHARE BUY-BACK PLANS

During the year, nil common shares (2007: 125,603) were purchased and cancelled at a cost of nil (2007: \$7.4 million) and 2,562,997 common shares were purchased to be held as treasury stock at a cost of \$38.3 million (2007: 967,119 shares at a cost of \$38.1 million).

During the same period, the Bank's Stock Option Trust bought nil common shares at a cost of nil (2007: 597,818 common shares at a cost of \$22.7 million).

The Board of Directors of the Bank authorised the repurchase over the twelve-month period commencing 1 January 2009, up to 3,000,000 of its common shares of par value \$1 each, pursuant to its share repurchase programme authorised by 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 than the last independent trade for a 'round lot', defined as 100 shares or more.

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

## NOTE 21: DIVIDEND RE-INVESTMENT AND EMPLOYEE COMMON STOCK PURCHASE PLANS

The Bank's dividend re-investment and employee common stock direct purchase plans permit participants to purchase, at 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: CAPITAL STRUCTURE

The Bank's authorised common share capital is \$260 million (par value: \$1.00).

At the Annual General Meeting of Shareholders held on 18 April 2007, the Directors were granted authority to issue redeemable preference share capital of US \$1,000,000 (par value US \$0.01) and £500,000 (par value of £0.01) which equates to a maximum amount of redeemable preference share capital of US \$100 million and £50 million respectively. The redeemable preference share capital is issuable with such powers, preferences and other rights, limitations and restrictions as may be determined appropriate by the Directors.

## NOTE 23: STOCK SPLIT AND STOCK DIVIDEND

In February 2008, the Bank distributed a 10% stock dividend to shareholders of record on 20 February 2008. All prior period per share data have been restated to reflect the stock dividend.

Shareholders of record at the close of business on 17 August 2007 were issued two additional shares of Butterfield Bank common stock on 31 August 2007 for each one share held as of the record date. All prior period per share data have been restated to reflect the three for one stock split.

## NOTE 24: VARIABLE INTEREST ENTITIES

During the first quarter of 2008, Management conducted an economic analysis of its investments in variable interest entities and determined that the Bank had ceased to be the primary beneficiary of expected gains or losses in these entities. The Bank has not made new investments in variable interest entities during the year. As a result, there was no effect of FIN 46R on the Bank's net assets for the year ended 31 December 2008 (2007: decrease of \$1.9 million). As at 31 December 2008 the total assets of variable interest entities consolidated in the balance sheet is nil (2007: \$31.4 million).

## NOTE 25: INCOME TAXES

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

31 December	2008	2007
<b>Income taxes in Consolidated Statement of Income</b>		
Current	3,168	6,977
Deferred	(126)	-
<b>Total tax expense</b>	<b>3,042</b>	<b>6,977</b>
<b>Deferred income tax asset</b>		
Tax loss carried forward	557	444
Pension liability	797	707
Allowance for compensated absence	19	31
Onerous leases	-	147
Other	1,185	2,831
<b>Total asset</b>	<b>2,558</b>	<b>4,160</b>
<b>Deferred income tax liability</b>		
Other	756	1,338
<b>Net deferred income tax asset</b>	<b>1,802</b>	<b>2,822</b>

For the years ended 31 December 2008 and 2007, there were no unrecognised tax benefits and the tax related interest and penalties recognised in net income were nil. The Bank is no longer subject to federal, state and local income tax examinations by tax authorities for years before 1999.

## NOTE 26: FUTURE ACCOUNTING DEVELOPMENTS

### (a) Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities

In June 2008, the Financial Accounting Standards Board (FASB) issued the FASB Staff Position (FSP) No. EITF 03-6-1, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP No. EITF 03-6-1), which specifies that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents are "participating securities" and therefore should be included in computing earnings per share. FSP No. EITF 03-6-1 will be effective for fiscal years beginning after 15 December 2008 and therefore effective from the Bank's first quarter in 2009. There will be no effect on adoption as the Bank is already in compliance.

### (b) Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlements)

In May 2008, the Financial Accounting Standards Board (FASB) issued the FASB Staff Position (FSP) No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial cash Settlements) (FSP No. APB 14-1), which specifies that issuers of this type of convertible debt account for the liability and equity components separately. The initial measurement of the liability component is to be consistent with similar non-convertible debt as of the issuance date. The convertible debt proceeds less the fair value of the liability component is recorded as additional paid-in capital. FSP No. APB 14-1 will be effective for fiscal years beginning after 15 December 2008 and therefore, effective from the Bank's first quarter in 2009. Currently, the bank is not an issuer of debt instruments considered by this FSP, therefore management does not expect any effect of adoption.

### (c) Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133

In March 2008, the FASB issued Statement of Financial Accounting Standards (SFAS) No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS 161), which addresses how companies should disclose information about derivative instruments and hedging activities. SFAS 161 is designed to improve the relevance, comparability, and transparency of financial information relating to derivative instruments and hedging activities. SFAS 161 will be effective for fiscal years beginning after 15 December 2008 and therefore, effective from the Bank's first quarter in 2009. Management is currently evaluating the effect of adoption.

### (d) Disclosure about Assets of Employee Future Benefits Plans

In December 2008, the FASB issued FASB Staff Position (FSP) No. FAS 132(R)-1, Employer's Disclosures about Postretirement Benefit Plan Assets (FSP No. FAS 132(R)-1), which addresses information that employers shall disclose about postretirement plan assets as of each annual reporting date. FSP No. FAS 132(R)-1 is designed to improve the relevance, comparability, and transparency of financial information relating to Postretirement Benefit Plan Assets. FSP No. FAS 132(R)-1 will be effective for fiscal years ending after 15 December 2009, and therefore, effective from the Bank's fourth quarter in 2009. Management is currently evaluating the effect of adoption.

### (e) Non-controlling Interests in Consolidated Financial Statements

In December 2007, the FASB issued SFAS No. 160, Non-controlling Interest in Consolidated Financial Statements (SFAS 160), which addresses how companies should measure and present non-controlling interests. SFAS 160 is designed to improve the relevance, comparability, and transparency of financial information relating to non-controlling interests. SFAS 160 will be effective for fiscal years beginning after 15 December 2008 and therefore, effective from the Bank's first quarter in 2009. Management is currently evaluating the effect of adoption.

### (f) Business Combinations

In December 2007, the FASB issued SFAS No. 141 (Revised), Business Combinations (SFAS 141R), which addresses how companies should recognise and measure assets and liabilities acquired through business combinations. SFAS 141R is designed to improve the relevance and comparability of financial information relating to business combinations. SFAS 141R will be effective for fiscal years beginning after 15 December 2008 and therefore, effective from the Bank's first quarter in 2009. Management is currently evaluating the effect of adoption.

## NOTE 27: COMPARATIVE INFORMATION

Certain prior period figures have been reclassified to conform to current period presentation.

## NOTE 28: SUBSEQUENT EVENT

Butterfield announced on 5 March 2009, that subject to shareholder approval, it will issue of \$200 million of perpetual non-cumulative preference shares (the Issuance), which qualify as Tier 1 capital, and which will be underwritten and guaranteed by the Government of Bermuda, with a closing date of 30 June 2009.

The Government has agreed to support the Issuance by guaranteeing the principal of, and dividend payments on, the preference shares. In addition, the Government has committed to purchase any preference shares from this offering that are not subscribed by private investors. In exchange for the Government's commitment, the Bank has agreed to issue to the Government 10-year warrants to purchase common shares of the Bank, representing some 4% of the issued shares of the Bank as at 31 December 2008, at an exercise price of \$7.01 and to pay the Government a guarantee fee of 1% per annum with respect to any preference shares issued to private investors.

On a proforma basis, as at 31 December 2008, the issuance of these preference shares would increase Butterfield Group's tier 1 capital ratio to 10.6% and its total capital ratio to 15.1%.

# SHAREHOLDER INFORMATION

## 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 2008 were 571,713 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 and Graham C. Brooks, Executive Vice President, International, whose contracts expire on 1 January 2012 and 1 August 2009, respectively.

## DIVIDEND PAYMENT

Dividends declared by the Board are paid quarterly, normally 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 Exchange (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 STOCK EXCHANGE

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

### SHARE DEALING SERVICE

Butterfield Securities (Bermuda) Limited  
65 Front Street  
Hamilton, HM 12  
Bermuda  
Tel: (441) 299 3972  
Fax: (441) 296 8867  
E-mail: info@butterfieldgroup.com

### SHARE PRICE

Published daily in *The Royal Gazette* in Bermuda and available on *Bloomberg Financial Markets* (symbol: NTB BH).

Also available on the BSX and CSX websites.

### DIVIDEND REINVESTMENT PLAN

Details are available from Butterfield Fulcrum Group (Bermuda) Limited (Phone: (441) 299 3882) and on our website, www.butterfieldgroup.com, under "About Us | Investor Relations."

Certain restrictions apply.

### REGISTRAR AND TRANSFER AGENT

Butterfield Fulcrum Group (Bermuda) Limited  
Rosebank Centre  
11 Bermudiana Road  
Pembroke, HM 11  
Bermuda  
Tel: (441) 299 3882  
Fax: (441) 295 6759

## MEDIA RELATIONS / PUBLICATION REQUESTS

Marketing & Corporate Communications  
Tel: (441) 299 1624 or (441) 298 4610  
E-mail: mark.johnson@bm.butterfieldgroup.com or stuart.roberts@bm.butterfieldgroup.com

## INVESTOR RELATIONS

Chief Financial Officer  
Tel: (441) 299 1643  
E-mail: richard.ferrett@butterfieldgroup.com

## WRITTEN NOTICE OF SHARE REPURCHASE PROGRAMME — BSX REGULATION 6.38

The Board of Directors of the Bank authorised the repurchase over the 12-month period commencing 1 January 2009, up to 3,000,000 of its ordinary shares of par value \$1 each pursuant to its share repurchase programme authorised by shareholders on 29 October 1997 and 18 April 2007.

As at 31 December 2008, 3,000,000 shares represented 3.05% 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.

Shares repurchased in the 12 months to 31 December 2008 totalled 2,563,017 at an aggregate cost of \$38,339,124 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 prearranged 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. No shares were purchased in this way in the 12 months to 31 December 2008.

## LARGE SHAREHOLDERS

The following professional nominees at 31 December 2008 were registered holders of 5% or more of the issued share capital:

Harcourt & Co. (17.01%) and Palmar Limited (5.94%).

Known beneficial holdings of 5% or more of issued share capital at that date were:

Bermuda Life Insurance Company Limited (7.05%)

## PRINCIPAL OFFICES & SUBSIDIARIES

*This list does not include all companies in the Group.*

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

Holding Company, Community Banking,  
Private Banking, Credit and Treasury Services

#### Head Office

65 Front Street  
Hamilton, HM 12  
Bermuda  
Tel: (441) 295 1111  
Fax: (441) 292 4365  
S.W.I.F.T. BNTB BM HM  
E-mail: info@butterfieldgroup.com

#### Mailing Address:

P.O. Box HM 195  
Hamilton, HM AX  
Bermuda

## BERMUDA

**Butterfield Asset Management Limited**  
Asset Management and  
Brokerage Services

#### Managing Director: Ian Coulman

65 Front Street  
Hamilton, HM 12  
Bermuda  
Tel: (441) 299 3817  
Fax: (441) 292 9947  
E-mail: bermuda@butterfieldgroup.com

**Butterfield Trust (Bermuda) Limited**  
**Grosvenor Trust Company Limited**  
Personal Trust, Corporate Trust and  
Custody Services

#### Managing Director: Michelle Wolfe

65 Front Street  
Hamilton, HM 12  
Bermuda  
Tel: (441) 299 3980  
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