Butterfield

The Bank of N.T. Butterfield & Son Limited
65 Front Street, Hamilton, Bermuda

www.butterfieldgroup.com

Butterfield Annual Report 2012

The Bank of N.T. Butterfield & Son Limited

In

2012

Annual Report

Butterfield

line
scope
essence

In brief

focus
sight
tune

Butterfield is committed to environmentally conscious printing. The following savings to our natural resources were realised in the printing of this Annual Report:

Energy: 5,874,649 BTUs
Trees: 8
Wastewater: 13,336 liters
Air Emissions: 348 kg
Solid Waste: 177 kg

MIX
Paper from responsible sources
FSC® C101537
www.fsc.org

As at 31 December 2012

In depth

Find out more at:
www.butterfieldgroup.com

$8.9 billion
Assets

Two Core Businesses
- Community Banking
- Wealth Management

1,210
Employees

Core Earnings
⇧ 45.2%

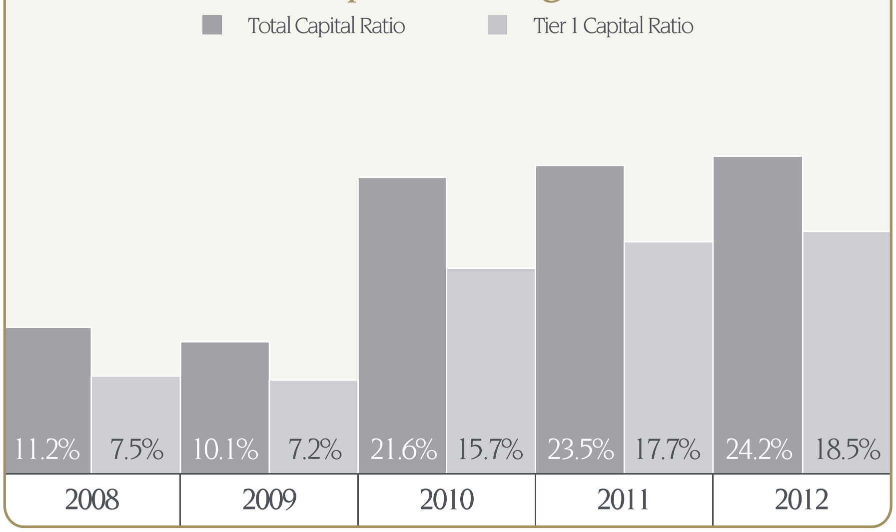
Efficiency Ratio improved by
479 bps

ROE*
⇧ 281 bps
*Core cash return on tangible common equity

Credit Ratings

Fitch		Moody's		Standard & Poor's	
Short-Term	Long-Term Senior	Short-Term	Long-Term Senior	Short-Term	Long-Term Senior
F1	A-	P-1	A2	A-2	A-

Capital Strength



Accolades

Six Butterfield employees named to *Citywealth* International Financial Centre Leaders List 2012

Euromoney 2012 Global Private Banking Survey

Best Private Banking Services Overall
(First in Bermuda, Eighth in Caribbean Region)

Best Relationship Management
(First in Bermuda and Cayman, Fourth in Caribbean Region)

Best Range of Investment Products
(First in Bermuda)

Best Net-Worth-Specific Services for Super-Affluent Clientele
(First in Cayman, Third in Caribbean Region)

time
order
sight

In review

motion
brief
hand

Chairman & Chief Executive Officer's Report to the Shareholders

Chairman & Chief Executive Officer's Report to the Shareholders

2012 was a year of continued recovery for Butterfield. The Bank's Board and Management team sought and delivered improved core earnings and Shareholder returns despite ongoing economic challenges in our main jurisdictions and very low interest rates. Whilst we made good progress in restoring value in the franchise, we continue to pursue opportunities to unlock greater value as we move forward.

Core earnings for the year ended 31 December 2012 were $54.9 million, up 45.2% over 2011 on gross revenues that increased by 1.5%. The improved core earnings reflect improvements in both our efficiency ratio and net interest margin.

2012 core earnings were offset by significant net one-time charges of $29.3 million stemming from more conservative valuations of certain Balance Sheet assets not related to core operations; primarily goodwill, intangible assets and estimates of the market value of real property owned and used by the Bank. As a result, 2012 net income was $25.6 million, reduced from $40.5 million in 2011.

In addition to growing core earnings, we improved the capital position of the Bank in 2012. The Tangible Common Equity Ratio increased by 28 basis points to 7.17%, the Tier 1 Capital Ratio improved to 18.53% (from 17.70% at year-end 2011), and the Total Capital Ratio ended the year at 24.18% (up from 23.50% at year-end 2011). Relative to many other banks, our capital position is very strong.

Core cash return on tangible common equity rose to 6.56% from 3.75%.

Asset growth of $425 million, resulting primarily from increased values of securities in the Bank's investment portfolios, drove improvements in Shareholder value. Net book value per Share rose to $1.20 from $1.14 and tangible book value per Share improved from $1.05 to $1.16.

To continue to effect improvements in financial performance whilst maintaining strong ratios, the Bank is following a focused strategy for the deployment of capital. That strategy involves allocating funds to initiatives that directly improve the franchise value, and applying excess capital and proceeds from the divestiture of non-core holdings to core businesses and projects that will drive continued growth.

IN THE INTERESTS OF SHAREHOLDERS

As a means of improving trading liquidity and potential returns on equity, your Board authorised a Share Buy-back Programme in May 2012 and increased the repurchase allowance in December to 10 million Common Shares and 8,000 Preference Shares. At year end, the Bank had repurchased 7.3 million Common Shares at a cost of $9.0 million, and 4,422 Preference Shares at a cost of $5.4 million.

Given the Bank's ratios, and against a backdrop of the limited lending and investment opportunities available in the current economic environment, your Board determined that it was appropriate to return a portion of the Bank's capital to Shareholders as income. On 26 February 2013, the Board declared a special dividend of $0.04 per Common and Contingent Value Convertible Preference Share to be paid on 22 March 2013 to Shareholders of record on 5 March 2013.

IN PURSUIT OF IMPROVED EARNINGS

Butterfield undertook or accelerated a number of initiatives in 2012 that proved beneficial to earnings and which will contribute to improving the Bank's sustainable profitability over the long term.

A 16 basis point increase in the net interest margin was achieved principally through a more disciplined investment approach—matching investment maturities to deposit aging—that resulted in the purchase of longer duration, higher-yielding (primarily US Government agency) securities for the Bank's portfolio. Butterfield benefits from stability and predictability in our deposit base, which allows for the effective application of such an approach, and also provides us with more latitude to widen margins via deposit pricing than is the case for some other financial institutions.

The Bank sold its holdings in selected non-core assets, specifically its wholly-owned Barbados subsidiary and its interest in the Cayman-based Island Heritage insurance company during the year. Those transactions generated proceeds of $63.5 million. The capital and Management resources that the sale of those assets freed will be deployed in the ongoing development of our core businesses; those in which we believe we have the scale, market presence and expertise to foster material growth going forward.

Managing costs remains a key area of focus for the Management team. During 2012, we reduced non-interest expenses by more than $12 million. Headcount continues to be reduced across the Group, enabled by changes in technology, process improvements, declines in transaction volumes in some areas owing to the current economic climate, and changes in customer behaviour.

The Bank also continues to seek ways to streamline operations as a means of managing expenses. During 2012, we made organisational and process changes to extract efficiencies from the previous centralisation of key functions in the areas of human resources, project management, information technology, compliance and risk management. We are seeking to reduce duplication of effort and synchronise our policies and procedures to create savings and improve customer service. In our two retail banking jurisdictions, Bermuda and Cayman (which now use a common banking technology platform), we are in the process of rationalising and simplifying our product lineups to ensure customers in both markets have access to our best offerings, whilst reducing the costs of back-office processing and administration. In 2013, we will complete the installation of a common system supporting our UK and Guernsey banking businesses, which will provide similar opportunities for operational improvements and cost savings.

IN BOARD MATTERS

Three new Directors joined the Board during 2012—Independent, Non-Executive Director Alastair Barbour, Non-Executive Director Olivier Sarkozy (as one of Carlyle's representatives), and myself—respectively filling the vacancies created by Robert Steinhoff, James Burr and Robert Mulderig upon their retirements from the Board in May. In June, sitting Independent, Non-Executive Director Barclay Simmons was named Vice Chairman.

Bradford Kopp stepped down from the Board upon his resignation as Butterfield's Chief Executive Officer in August. Shaun Morris resigned as a Director upon being appointed the Group's General Counsel and Chief Legal Officer, and in that capacity, Mr. Morris now serves as Secretary to the Board of Directors.

IN THE COMMUNITY

Butterfield's long-term success and growth is tied to the prosperity of the jurisdictions we serve. Across the Group in 2012, we supported worthy causes that helped enrich and improve the lives of people in our communities. In Bermuda, the Bank focused its corporate giving efforts through the Butterfield Hope Award, making contributions to many local charities. Cayman sponsored several health, wellness and educational initiatives, and was an active member and supporter of industry-led organisations that foster the ongoing development of financial services in the jurisdiction. Our Guernsey subsidiaries once again sponsored a number of youth and sports-related events to raise the community profile of the businesses there, and our UK bank made a number of donations to charities connected to our private clients during the year.

I was honoured to have been appointed Butterfield's Chairman & Chief Executive Officer in 2012, and I look forward to continuing to work with my fellow Directors and Management to advance the Bank's recovery. I would like to express my appreciation to our customers for their loyalty to the Bank, our employees for their continued dedication and hard work, and to the Shareholders for your ongoing support.

Brendan McDonagh
Chairman & Chief Executive Officer

sight
particular
motion

In unison

order
detail
scope

Board of Directors & Group Executive Management

Board of Directors
& Principal Board Committees

COMMITTEES INDICATED BY NUMBERS

1
CHAIRMAN
BRENDAN MCDONAGH
Chief Executive Officer,
The Bank of N.T. Butterfield & Son Limited

1,3,5
VICE CHAIRMAN
BARCLAY SIMMONS*
Managing Partner,
Attride-Stirling & Woloniecki, Barristers & Attorneys

2,4
ALASTAIR BARBOUR*
Director, RSA Insurance Group plc, Liontrust Asset Management plc, Standard Life European Private Equity Trust plc, CATCo Reinsurance Opportunities Fund Ltd, CATCo Reinsurance Fund Limited and Scottish Equitable Policyholders Trust Limited

3,4
VICTOR DODIG
Senior Executive Vice-President and
Group Head, Wealth Management, CIBC

2,4
SHEILA LINES*
Retired Chief Executive Officer,
KeyTech Limited

1,2,4
PAULINE RICHARDS*
Chief Operating Officer,
Armour Reinsurance Group Holdings Limited
Director, Wyndham Worldwide Inc.
Former Director and Audit Committee Chair,
Cendant Corporation

4,5
OLIVIER SARKOZY
Managing Director and Head of The Carlyle Group's
Global Financial Services Group

1,3
WOLFGANG SCHOELLKOPF
Managing Partner,
Lykos Capital Management

1,3,5
RICHARD VENN
Senior Executive Vice-President,
Advisor to the CEO Office, CIBC

3
JOHN WRIGHT*
Retired Bank Chief Executive

PRINCIPAL BOARD COMMITTEES

1. EXECUTIVE COMMITTEE OF THE BOARD OF DIRECTORS
Supports the Board in fulfilling its overall governance responsibilities.

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

3. RISK POLICY & COMPLIANCE COMMITTEE
Focuses on credit, market and operational risk.

4. CORPORATE GOVERNANCE COMMITTEE
Focuses on Directors' and Board Committee governance, performance and Directors' nominations.

5. COMPENSATION & HUMAN RESOURCES COMMITTEE
Focuses on compensation and benefits, employee development and succession.

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.

*Independent, Non-Executive Director. On an annual basis, the Corporate Governance Committee ensures the appropriate composition of the Board and its Committees in accordance with the Group's Corporate Governance Policy. The assessment of the independence of a Director is based upon a number of factors including, but not limited to: whether he or she has been employed by the Group within the last five years; whether he or she has had, within the last three years, a material relationship with the Group; and whether he or she represents a significant Shareholder.

Group Executive Management

BRENDAN MCDONAGH
Chairman & Chief Executive Officer

MICHAEL COLLINS
Senior Executive Vice President
Bermuda

CONOR O'DEA
Senior Executive Vice President
International Banking

DANIEL FRUMKIN
Executive Vice President
Chief Risk Officer

DONNA HARVEY MAYBURY
Executive Vice President
Human Resources

ROBERT MOORE
Executive Vice President
Head of Group Trust

SHAUN MORRIS
General Counsel
Group Chief Legal Officer

MICHAEL NEFF
Executive Vice President
Head of Group Asset Management

BRADLEY ROWSE
Executive Vice President
Chief Financial Officer

JAMES MCPHERSON
Senior Vice President
Group Internal Audit

In detail

touch
focus
line
essence
brief
balance

Table of Contents

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

The financial overview of results of operations and financial condition should be read in conjunction with our Consolidated Financial Statements and the related notes. The financial statements and notes have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP). All references to "Butterfield", the "Group" or the "Bank" refer to The Bank of N.T. Butterfield & Son Limited and its subsidiaries on a consolidated basis. 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.

PERFORMANCE MEASUREMENT

We use a number of financial measures to assess the performance of our business lines. Some measures are calculated in accordance with GAAP, while other measures do not have a standardised meaning under GAAP. Accordingly, these measures, described below, may not be comparable to similar measures used by other companies. Investors may however find these non-GAAP financial measures useful in analysing financial performance.

Core Cash Return on Tangible Common Equity ("CCROTCE")

CCROTCE measures core cash profitability as a percentage of tangible common equity. CCROTCE is the amount of core net income excluding amortisation of intangible assets returned as a percentage of tangible common equity and calculated as Core Cash Net Income / Tangible Common Equity. Core cash net income is for the full fiscal year (before dividends paid to Common Shareholders but after dividends to Preference Shareholders) adjusted for one-off items not in the ordinary course of business plus amortisation of intangible assets expensed in the year. Tangible common equity does not include the Preference Shareholders' equity or goodwill and intangible assets.

Return on Common Shareholders' Equity ("ROE")

ROE measures profitability by revealing how much profit is generated with the money invested by Common Shareholders. ROE is the amount of net income returned as a percentage of Common Shareholders' Equity and calculated as Net Income / Average Common Shareholders' Equity. Net income is for the full fiscal year (before dividends paid to Common Shareholders but after dividends to Preference Shareholders). Common Shareholders' Equity does not include the Preference Shareholders' equity.

Return on Assets ("ROA")

ROA is an indicator of profitability relative to total assets. ROA demonstrates how efficient Management is at using its assets to generate earnings. The ROA ratio is calculated as Annual Net Income / Average Total Assets.

Tier 1 Capital Ratio

The Tier 1 Capital Ratio is the ratio of the Bank's core equity capital, as measured under Basel II, to its total risk-weighted assets ("RWA"). Risk-weighted assets are the total of all assets held by the Bank weighted by credit risk according to a formula determined by the Regulator. The Bank follows the Basel Committee on Banking Supervision ("BCBS") guidelines in setting formulae for asset risk weights.

Tier 1 Common Ratio

The Tier 1 Common Ratio is the same as the Tier 1 Capital Ratio but only includes common equity in the numerator and deducts the Preference Shareholders' equity.

Total Capital Ratio

The Total Capital Ratio measures the amount of the Bank's capital in relation to the amount of risk it is taking. All banks must ensure that a reasonable proportion of their risk is covered by permanent capital. Under Basel II, Pillar I, banks must maintain a minimum Total Capital Ratio of 8%. In effect, this means that 8% of the risk-weighted assets must be covered by permanent or near permanent capital. The risk weighting process takes into account the relative risk of various types of lending. The higher the Capital Adequacy Ratio a bank has, the greater the level of unexpected losses it can absorb before becoming insolvent.

Tangible Common Equity / Tangible Asset Ratio ("TCE/TA")

TCE/TA is used to determine how much loss the Bank can take before other forms of capital, other than common equity, are impacted. The TCE/TA ratio is calculated as (Common Equity - Intangible Assets - Goodwill) / Tangible Assets. Tangible common equity does not include the Preference Shareholders' equity or goodwill and intangible assets. Tangible assets are the Bank's total assets from continuing operations less goodwill and intangibles.

Net Interest Margin ("NIM")

NIM is a performance metric that examines how successful the Bank's investment decisions are compared to its cost of funding assets and is calculated as (Interest Income – Interest Expenses) / Average Interest Earning Assets. The daily average was used in calculating the average balance for deposits to avoid any distortion caused by large fluctuations at month ends.

Efficiency Ratio

The Efficiency Ratio is defined as non-interest expenses before amortisation of intangible assets and income taxes as a percentage of total revenue before gains and losses and provisions for credit losses.

ABOUT BUTTERFIELD

Established in 1858, Butterfield provides community banking and wealth management in Bermuda and select markets in the Caribbean and Europe. Today we are the largest independent bank in Bermuda and have a significant market position in the Cayman Islands. Group-wide, we have over 1,200 employees across six jurisdictions. Butterfield offers a full range of community banking services in Bermuda and the Cayman Islands, consisting of institutional, corporate, commercial and retail banking and treasury activities. In wealth management, we provide private banking, asset management, custody and trust services to individual, family, institutional and corporate clients from our headquarters in Bermuda and subsidiary offices in The Bahamas, the Cayman Islands, Guernsey, Switzerland and the United Kingdom.

BUSINESS STRATEGY

Whilst remaining well capitalised with strong liquidity, our strategic focus is on building Shareholder value by expanding our share of the community and private banking markets in jurisdictions in which we have a meaningful presence and a depth of local market knowledge. Our strategy also involves leveraging our multi-jurisdictional trust, custody and asset management offerings to build our wealth management business from both cross-referrals with existing customers and business development through referrals and relationships with fiduciaries and advisers. We aim to build upon our relationship-based business approach by delivering exceptional client service experiences, as well as a wide range of products to meet our clients' financial services needs.

The wide range of products on offer is reflective of our strategy of pursuing opportunities in diversified businesses including community banking, private banking, asset management, custody, corporate trust and personal trust services. Those diverse businesses directly contribute to the high level of fee income relative to our total income. Despite the current economic environment reducing the volume of customer activity, our fee income remains at almost 38% of revenue before credit provisions and gains or losses.

Building on our community banking and wealth management strategies will also leverage our strong and loyal client base. Unlike many banks, Butterfield is almost exclusively funded by our Shareholders and customers. Our core customer deposits have been remarkably stable throughout the credit crisis. In 2012, we focused on these core deposits and pricing discipline to significantly improve their contribution to net interest income. This contribution reflects the strength of being a deposit-led organisation even in times of low interest rates.

To support our strategy, our Management structure is aligned to focus on lines of business and central support services with increasingly less emphasis on independent management and support teams by jurisdiction. However, we remain flexible and nimble in each jurisdiction, with decision making on client service-related matters based locally. In addition, we have invested heavily—and continue to invest—in new technology that allows for new and flexible products, enhanced customer service and a streamlined, more efficient operation. We expect our recent investment in new core banking systems in our two largest markets (Bermuda and Cayman), and upgrades in progress in Guernsey and the United Kingdom, will help drive new revenue opportunities, improved internal control, and operational efficiencies. Our strategy of moving to centralised support services and centres of excellence is enhanced by these technological investments and will drive further efficiencies.

Given the large, loyal customer deposit base enjoyed in our main jurisdictions, and the relatively low volume of lending demand from our customer base, our investment strategy is more important than is the case for most financial institutions. At 31 December 2012, we had $4.6 billion of cash and investments representing 51.5% of total assets. In recognition of this defining characteristic of Butterfield, we have adopted a conservative approach to our investments, including significantly reducing the list of international banks from whom we will purchase certificates of deposits. With the help of our investment advisers we continued to manage our Interest Rate Risk, which measures the degree to which our profitability is at risk due to changes in interest rates. Our focused investment strategy has allowed us to improve the profitability of our investments despite the ongoing challenges of a poor and volatile investment climate, whilst minimising credit risk in the investment book. Our continued management of Interest Rate Risk requires us to purchase fixed rate investments that, whilst complying with our credit safety requirements, will experience temporary declines in market values when rates start to increase. Rising interest rates will improve the profitability of Butterfield, such that these anticipated negative marks are part of our strategy. They will not affect earnings, as they are not credit related, but they will potentially give rise to negative impacts in equity through "Other

Comprehensive Income" due to accounting rules for Available-For-Sale ("AFS") investments. To minimise the impact on our equity in such circumstances, while implementing proper management of Interest Rate Risk, we have increased the Held-to-Maturity ("HTM") portfolio to $239 million at year end.

2012 OVERVIEW

In 2012, the Bank made solid progress, selling non-core holdings, streamlining and coordinating operations across jurisdictions, focusing on effective expense management and instituting a Share Buy-Back Programme. Core earnings improved, as a result, by $17.1 million to $54.9 million, building on our very strong capital position with Total and Tier 1 Capital Ratios of 24.2% and 18.5% respectively. The Board continues to monitor capital levels, maintaining a conservative capital management philosophy such that Butterfield remains well capitalised. To further enhance Common Shareholder returns, the Board has declared a special dividend of $0.04 per Share. On a going-forward basis, the Board will continue to assess capital planning options and declare dividends as warranted, subject to regulatory approval.

The Bank's Balance Sheet remains strong, with Shareholders' equity ending the year up $27 million at $857 million, of which $196 million is 8% Preference Shareholders' equity and $661 million is Common and Contingent Value Convertible Preference Shareholders' equity ("common equity"). Total assets grew by $118 million to $8.9 billion, but when adjusted for the $307 million of assets from discontinued operations in the prior year, total assets grew by $425 million, primarily reflecting a $245 million increase in deposits, $109 million of funding from repurchase agreements, and a $27 million increase in Shareholders' equity.

Loans and advances to customers decreased from 2011 levels by $113 million largely reflecting the $226 million repayment of a Bermuda Government loan offset by loan growth in our European operations, principally low loan-to-value residential mortgages secured by prime Central London property.

Core deposit levels showed resilience in this low interest rate environment. Total deposits grew $244 million over 2011 to $7.5 billion, a reflection of Butterfield's strategy targeting certain segments of the deposit market.

Key accomplishments in 2012 were as follows:

- **Core profitability:** The Bank delivered good growth in core net income, up $17.1 million (45.2%) to $54.9 million (7 cents per Share) from $37.8 million in 2011.

- **Capital:** We maintained a strong capital position, with over $1.0 billion of regulatory capital, a Tier 1 Capital Ratio of 18.5% at 31 December 2012, with a TCE/TA ratio of 7.2%, up from 6.9% in 2011.

- **Investment strategy:** We continued our investment strategy for the deployment of excess liquidity that contributed to our NIM increasing by 16 basis points, from 2.42% in 2011 to 2.58% in 2012, despite an environment of continued low interest rates.

- **Expenses:** We reduced non-interest expenses by $12.4 million (4.3%), from $286.6 million in 2011, to $274.2 million in 2012.

- **Headcount:** Across the Group, headcount was reduced by 60 (4.7%) from 1,270 as at 31 December 2011 to 1,210 by the end of 2012 on a full-time equivalent basis.

- **Deposits:** The Bank maintained stable core customer deposits, whilst decreasing deposit costs by 10 basis points, from 43 basis points in 2011 to 33 basis points in 2012.

- **Loan quality:** Gross non-accrual loans as a percentage of gross loans held relatively flat at 2.8% at year-end 2012 compared to 2.7% at year-end 2011. Net non-accrual loans were $86.6 million, equivalent to 2.2% of total loans, after specific provisions for such loans of $26.7 million, reflecting an improved specific coverage ratio of 23.6%, up from 21.3% at 31 December 2011.

- **Systems:** We continued preparations for a common technology system in Europe and have successfully upgraded the UK system subsequent to year-end, with plans to upgrade Guernsey by year-end 2013.

MARKET ENVIRONMENT

In 2012, the economic environment in the United States ("US") improved over the year. Gross Domestic Product ("GDP") growth remained positive, albeit at an uninspiring rate, the unemployment rate continued to slowly drift lower, the housing market improved and appears to have returned to a net creator of economic growth, and an agreement was reached to avoid the worst of the "fiscal cliff" in early 2013. In Europe, the economy remains in a very difficult situation with weakness in the peripheral economies making its way into the core. With heightened levels of unemployment and the restraints of a common currency, there are indications that Europe will not emerge quickly from its credit crisis. Some comfort was taken by the markets from the European Central Bank's Outright Monetary Transactions programme, which removed funding issues earlier in the year. The impacts of the global economic conditions on the economies in which we operate were mixed. Bermuda has continued to experience rising unemployment, a shrinking population and declining GDP, whilst Cayman began to see encouraging signs of growth, including growth in air arrivals, population and infrastructure spending. However, in Bermuda the change in government in late 2012 has delivered a Government agenda focused on job creation, which is expected to translate into more policy changes targeted at bringing new business to the island. The mixed economic climate in our two largest operations in 2012 resulted in limited loan demand and more pressure on customers' ability to service loan payment obligations. Conversely, our private banking business in Europe continued to enjoy strong loan demand resulting in growth in our low loan-to-value residential mortgage portfolio to high net worth customers.

Amidst this macroeconomic uncertainty, the Bank continues to maintain a highly liquid Balance Sheet with a low risk investment portfolio and minimal reliance on wholesale money markets for liquidity.

2013 OUTLOOK

The past few years have tested the ability of market researchers with ongoing changes and adjustments to economic forecasts. 2011 was a year of extreme volatility with investors fleeing to quality, followed by a year of increasing stability in 2012. Many market participants began to return to the (still volatile) equity markets, comforted by the continued support of the central banks through bond buying programmes. What does that mean for the year ahead? Long-term interest rates are beginning to rise above historic lows, but given the central banks' intent of maintaining low interest rates, many financial institutions remain focused on optimising their business models, adjusting to the current economic conditions; Butterfield is no exception.

Low interest rates are expected to continue in 2013, however, our asset and liability management strategy focuses on net interest income at risk in varying interest rate environments. This means we position our Balance Sheet to maximise net interest income over a three to five-year period with investment flows matching our expected maturities and turnover on the liability side of the Balance Sheet, whilst partially neutralising the impact of changing interest rates in any given reporting period. These investments position us to not be reliant on rising rates to achieve adequate profitability. When higher rates occur, core profitability will be further improved. Higher rates will also have a restraining effect on capital levels as it reduces the market value of our longer dated securities in our AFS book, partially offset by lower liabilities for future pension and health costs for employees.

In 2013, our strategy remains relatively unchanged as we continue to focus our attention on the development of our core businesses, which we expect will drive revenue growth. We expect to be able to continue to improve our efficiency ratio in 2013 based on leveraging our investments in technology, redesigning processes and centralising support services. Incentive plans have been more closely aligned with business development and results targets and metrics that reflect Shareholders' interests.

FINANCIAL SUMMARY (in $ thousands, except per Share data)

As at 31 December	**2012**	**2011**	**2010**	**2009**	**2008**
Cash and cash equivalents	**1,651,547**	1,902,726	2,222,934	1,932,189	2,168,057
Short-term investments	**76,213**	20,280	18,157	14,881	17,019
Investments in debt and equity securities	**2,881,704**	2,061,639	2,764,723	2,899,668	3,789,136
Loans, net of allowance for credit losses	**3,955,960**	4,069,419	3,858,138	4,025,981	4,235,435
Premises, equipment and computer software	**243,321**	272,472	257,468	240,010	194,256
Goodwill and intangible assets	**22,276**	46,100	51,435	62,867	67,196
Assets of discontinued operations	**-**	307,044	276,573	281,524	268,227
Total assets	**8,942,030**	8,824,350	9,623,487	9,594,806	10,911,703
Total deposits	**7,502,259**	7,256,561	7,988,501	8,451,311	9,570,172
Subordinated capital	**260,000**	267,755	282,799	283,085	282,296
Shareholders' equity					
Preference Shareholders' equity	**195,578**	200,000	200,000	200,000	-
Common and Contingent Value Convertible Preference Shareholders' equity	**661,596**	629,725	609,289	155,460	518,440

For the year ended 31 December	**2012**	**2011**	**2010**	**2009**	**2008**
Net interest income before provision for credit losses	**211,058**	202,249	166,025	174,708	244,838
Provision for credit losses	**(14,190)**	(13,169)	(40,262)	(102,716)	(2,753)
Non-interest income (as reported)	**128,543**	132,349	143,264	148,473	209,312
Non-interest income (excluding fund administration services business)	**128,543**	132,349	143,264	148,473	173,729
Salaries and other employee benefits	**137,433**	145,136	153,246	151,346	178,194
Other non-interest expenses (including income taxes)	**142,705**	141,186	143,174	135,898	160,769
Net income (loss) before gains and losses	**45,273**	35,107	(27,393)	(66,779)	112,434
Net gains (losses)	**(27,312)**	4,238	(180,366)	(147,635)	(105,782)
Net income (loss) from continuing operations	**17,961**	39,345	(207,759)	(214,414)	6,652
Net income (loss) from discontinued operations	**7,620**	1,127	144	1,001	(2,028)
Net income (loss)	**25,581**	40,472	(207,615)	(213,413)	4,624
Dividends and guarantee fee of Preference Shares	**18,000**	21,270	18,000	9,450	-
Net income (loss) available to Common Shareholders	**7,581**	19,202	(225,615)	(222,863)	4,624
Common dividends paid	**-**	-	-	14,938	57,733

Financial ratios					
Return on assets [1]	**0.3%**	0.4%	(2.2%)	(2.1%)	-
Return on Common Shareholders' equity	**1.1%**	3.0%	(44.3%)	(47.0%)	0.8%
Tier 1 Capital Ratio	**18.5%**	17.7%	15.7%	7.2%	7.5%
Total Capital Ratio	**24.2%**	23.5%	21.6%	10.1%	11.2%
Tangible Common Equity Ratio	**7.2%**	6.9%	6.0%	1.0%	4.3%
Net interest margin	**2.58%**	2.42%	1.91%	1.90%	2.15%
Efficiency ratio	**79.27%**	84.06%	95.03%	87.26%	72.42%

Per participating share ($)					
Net income (diluted) [1]	**0.01**	0.03	(0.47)	(2.34)	0.05
Cash dividends [1]	**-**	-	-	0.12	0.52
Net book value [1]	**1.20**	1.14	1.10	1.64	5.44

Number of employees					
Bermuda	**615**	664	732	761	803
Overseas	**595**	606	649	708	774
Total	**1,210**	1,270	1,381	1,469	1,577

Other data					
Weighted average number of participating Shares on a fully diluted basis [2]	**556,357**	555,615	477,225	95,065	96,683
Risk-weighted assets	**4,275,055**	4,425,639	4,934,569	5,734,096	6,199,963

(1) Includes both Common and Contingent Value Convertible Preference Shareholders' equity.

(2) All prior period per Common Share data and number of Common Shares, with the exception of dividends, have been restated to reflect the $0.04 stock dividend declared for March, May, August and November 2009 and the one-for-ten stock dividend of February 2008.

CONSOLIDATED RESULTS OF OPERATIONS AND DISCUSSION FOR FISCAL YEAR ENDED 31 DECEMBER 2012

For 2012 and 2011, transactions that were viewed by Management as not being in the normal course of day-to-day business and unusual in nature were excluded from core earnings as they obscure or distort the analysis of trends. Certain earnings measures, such as core earnings, do not have standardised meanings as prescribed by GAAP and therefore are unlikely to be comparable to similar measures presented by other companies.

Net Income

The Bank reported net income of $25.6 million for the year ended 31 December 2012, compared to $40.5 million in 2011. Results in both years were adversely affected by various non-operating gains and losses. After deduction of Preference dividends ($16.0 million) and the guarantee fee ($2.0 million) on Preference Shares, the net income available to Common Shareholders was $7.6 million ($0.01 per Share) in 2012 compared to $19.2 million ($0.03 per Share) in 2011.

The following table states reported earnings for 2012 compared to 2011:

	Year ended 31 December			
(in $ millions)	**2012**	**2011**	**$ change**	**% change**
Non-interest income	**128.5**	132.4	(3.9)	(3.0%)
Net interest income before provision for credit losses	**211.1**	202.3	8.8	4.4%
Total revenue before provision for credit losses and gains and losses	**339.6**	334.7	4.9	1.5%
Net gains (losses)	**(27.3)**	4.2	(31.5)	N/A
Provision for credit losses	**(14.2)**	(13.2)	(1.0)	(7.6%)
Total net revenue	**298.1**	325.7	(27.6)	(8.5%)
Non-interest expenses	**(274.2)**	(286.6)	12.4	4.3%
Net income before taxes	**23.9**	39.1	(15.2)	(38.9%)
Income tax (expense) benefit	**(5.9)**	0.3	(6.2)	N/A
Net income from continuing operations	**18.0**	39.4	(21.4)	(54.3%)
Net income from discontinued operations	**7.6**	1.1	6.5	N/A
Net income	**25.6**	40.5	(14.9)	(36.8%)
Dividends and guarantee fee of Preference Shares	**(18.0)**	(21.3)	3.3	15.5%
Net earnings attributable to Common Shareholders	**7.6**	19.2	(11.6)	(60.4%)
Net earnings per Common Share				
- Basic	**0.01**	0.03	(0.02)	(66.7%)
- Diluted	**0.01**	0.03	(0.02)	(66.7%)

Core Earnings

The following table reconciles the Bank's GAAP net income for 2012 and 2011:

	Year ended 31 December	
(in $ millions)	**2012**	2011
Net income	**25.6**	40.5
Non-core items:		
Net income from discontinued operations [1]	**(7.6)**	(1.1)
Net gain on sale of affiliate [2]	**(4.2)**	(3.2)
Early retirement programme [3]	**2.2**	1.6
Impairment of goodwill and intangible assets [4]	**18.6**	-
Impairment of fixed assets [5]	**14.5**	-
Deferred tax valuation allowance and tax adjustments [6]	**5.0**	-
Onerous leases [7]	**0.8**	-
Total one-time items	**29.3**	(2.7)
Core earnings	**54.9**	37.8
EPS impact of non-core items	**0.05**	-
EPS core earnings – fully diluted	**0.07**	0.03

(1) During the third quarter of 2012, Butterfield sold its wholly-owned Barbados subsidiary, Butterfield Bank (Barbados) Limited, to Trinidad and Tobago-based First Citizens Bank Limited ("First Citizens") for a net gain of $7.2 million. As a result, the Barbados segment has been reported as discontinued operations. The operating results from this business were not material on a per Share basis; however, year-to-date net income includes $7.6 million of discontinued operations in 2012 and $1.1 million in 2011.

(2) In the second quarter of 2012, the Bank sold its 27.8% interest in Island Heritage Holdings Ltd., a Cayman-based insurance company, to BF&M Limited for gross proceeds of $18.5 million, resulting in a gain of $4.2 million. In the second quarter of 2011, the Bank sold its 36% equity interest on a diluted basis in Butterfield Fulcrum Group Limited ("BFG") for a gain of $3.2 million.

(3) As part of the Bank's cost reduction programme, incentive packages for optional early retirement were offered to eligible employees. In 2012 and 2011, the cost of this programme, recorded in salaries and other employee benefits, amounted to $2.2 million and $1.6 million respectively.

(4) The Bank's annual impairment test concluded that the carrying amount of goodwill and intangible assets of our United Kingdom segment was considered fully impaired due to a continuous period of losses incurred and future estimated profitability being unable to sustain current valuations. The intangible asset of the Bahamas segment was impaired as the present value of net cash flows expected to be derived for the remaining customer base is significantly less than the expectations as at the acquisition date.

(5) The Bank's annual property impairment assessment resulted in the impairment of various properties and a write down of $6.5 million was recorded as the carrying value was not considered recoverable. Additionally at the end of 2012, the Bank changed its commitment with respect to certain Bermuda properties which were being used in its operations but are now held for sale and, therefore, the properties have been reclassified to other real estate owned assets in the Consolidated Balance Sheet. The reclassification resulted in an $8 million write down of the carrying amount to its fair value less cost to sell.

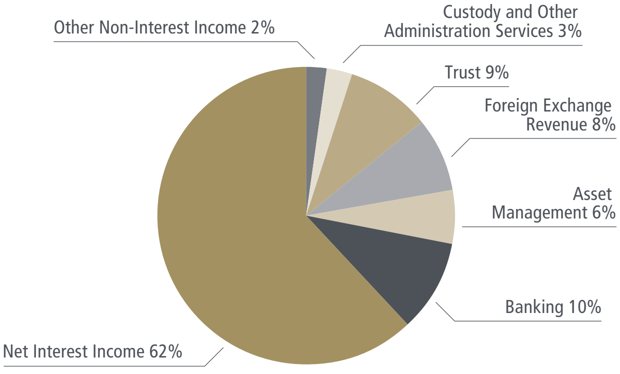
(6) Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to utilise deferred tax assets. A significant piece of objective negative evidence evaluated with respect to our UK bank was the cumulative loss incurred over the three-year period ended 31 December 2012. Such objective evidence limits the ability to consider other subjective evidence such as our projections for future growth. On the basis of this evaluation, as of 31 December 2012, a deferred tax valuation allowance of $4.1 million was recognised in addition to $0.9 million of tax adjustments related to the prior year.

(7) The Bank leases certain properties in the normal course of business. Certain of the leased premises have been subleased. If the net present value of the lease obligations exceeds the expected rent receipts, an onerous lease charge is recognised. During 2012, $0.8 million of such charges were recognised.

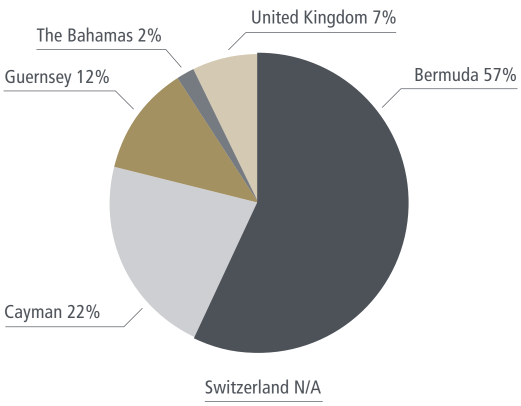
Revenue

Total revenue before provisions for credit losses and gains and losses for 2012 was $339.6 million, up $4.9 million (1.5%) from $334.7 million in 2011. Total non-interest income was down $3.9 million (2.9%) from $132.4 million in 2011 to $128.5 million in 2012, which was more than offset by the $8.8 million increase in net interest income before provisions for credit losses from $202.3 million in 2011 to $211.1 million in 2012. The increase in net interest income was driven by a 16 basis point increase in the net interest margin, from 2.42% in 2011 to 2.58% in 2012. The efficient deployment of excess liquidity under our new investment strategy, loan growth and disciplined deposit pricing drove the improvement in the net interest margin despite the sustained low interest rate environment.

DISTRIBUTION OF 2012 TOTAL REVENUES BEFORE PROVISIONS FOR CREDIT LOSSES AND GAINS AND LOSSES



DISTRIBUTION OF 2012 TOTAL REVENUES BY LOCATION BEFORE PROVISIONS FOR CREDIT LOSSES AND GAINS AND LOSSES



Non-Interest Income

Non-interest income is a function of a number of factors including the composition and value of client assets under management and administration, the volume and nature of clients' transaction activities, and the types of products and services our clients use. Our fee structure provides for varied pricing that depends on the value of client assets and the nature of services provided. As a result, it is not always possible to draw a direct relationship between the value of client assets and the level of non-interest income, although the trend of non-interest income generally follows the trend in client asset levels.

Total non-interest income was down $3.9 million from $132.4 million in 2011 to $128.5 million in 2012 and represents 38% of total revenues before provisions for credit losses and gains and losses for 2012, compared to 40% in 2011.

The following table presents the components of non-interest income for the years ended 31 December 2012 and 2011:

(in $ thousands)	2012	2011	$ change	% change
Asset management	**22,323**	22,942	(619)	(2.7%)
Banking	**33,713**	31,648	2,065	6.5%
Foreign exchange revenue	**26,524**	30,277	(3,753)	(12.4%)
Trust	**29,122**	29,451	(329)	(1.1%)
Custody and other administration services	**10,646**	12,324	(1,678)	(13.6%)
Other non-interest income	**6,215**	5,707	508	8.9%
Total non-interest income	**128,543**	132,349	(3,806)	(2.9%)

Asset Management

Asset management revenues are generally based on the market value of assets managed and the volume of transactions and fees for other services rendered. We provide asset management services from our offices in Bermuda, the Cayman Islands, Guernsey and the United Kingdom. Revenues from asset management were $22.3 million in 2012, compared to $22.9 million in 2011; the $0.6 million decrease is principally a result of the termination of the management agreement with Bentley Reid in the second quarter of 2012, offset by an increase in fees earned on the Butterfield Money Market Fund as a result of higher LIBOR rates. Assets under management decreased by $0.9 billion to end at $4.7 billion for 2012 due to the terminated agreement with Bentley Reid and due to a decline in Money Market balances as clients sought better yielding alternatives for short-term investments.

The table that follows shows the changes in the year-end values of clients' assets under management, sub-divided between those managed for clients on a discretionary basis and those client funds invested in mutual funds that Butterfield manages:

(in $ thousands)	2012	2011	$ change	% change
Butterfield Funds	**2,869**	3,375	(506)	(15.0%)
Discretionary	**1,871**	2,269	(398)	(17.5%)
Total assets under management	**4,740**	5,644	(904)	(16.0%)

Banking

During 2012, Butterfield provided a full range of community, commercial and private banking services in select jurisdictions. Community banking services are offered to individuals and small to medium-sized businesses through branch locations, telephone banking, Internet banking, automated teller machines and debit cards in Bermuda and the Cayman Islands, whilst private banking services were offered in Bermuda, the Cayman Islands, Guernsey and the United Kingdom. Banking fee revenues reflect loan, transaction and processing and other fees earned in these jurisdictions. Banking fee revenues increased by 6.5% in 2012 to $33.7 million, compared to $31.6 million in 2011, primarily as a result of loan prepayment penalty fee revenue received during 2012.

Foreign Exchange

We provide foreign exchange services in the normal course of business in all jurisdictions. The major contributors to foreign exchange revenues are Bermuda and the Cayman Islands, accounting for 83% of the Group's foreign exchange revenue (2011: 80%). The Bank does not have a proprietary trading book. Foreign exchange income is thus generated from client-driven transactions and totalled $26.5 million in 2012, compared with $30.3 million in 2011. The $3.8 million year-on-year decrease reflects declining client volumes, in line with the slowing economic conditions, and lower margins on institutional transactions as a result of intensifying competition from online platforms.

Trust

We provide both personal and institutional trust services from our operations in Bermuda, The Bahamas, the Cayman Islands, Guernsey and Switzerland. Trust revenues are derived from a combination of fixed fees, fees based on the market values of assets held in trust and fees based on time spent in relation to the range of personal trust and company administration services and pension and employee benefit trust services we provide. In 2012, trust revenues totalled $29.1 million, marginally lower than the $29.5 million recorded in 2011 due mainly to substantial one-time fees in 2011 which did not recur in 2012 and also to the loss of one managed trust company mandate during 2011 offset by an increase in recurring income through structured, proactive business development activities, with good new business growth in our Switzerland, Guernsey and Bermuda trust businesses and increasing pipelines in our Bahamas and Cayman businesses. Trust revenues represented 23% of total non-interest income in 2012, up from 22% in 2011. Total Trust assets under administration were $47.1 billion as at 31 December 2012 compared to $43.9 billion the prior year.

Custody and Other Administration Services

Custody fees are generally based on market values of assets in custody, the volume of transactions and flat fees for other services rendered. We provide custody services from our offices in Bermuda, the Cayman Islands, Guernsey and the United Kingdom, and other administration services — primarily administered banking — in Guernsey. In 2012, revenues were $10.6 million compared to $12.3 million in 2011, down 13.6%, in part due to lower transaction volumes and expired mandates in our custody business, and partly due to a reduction in administered banking mandates. Total custody and other administration assets under administration (which includes the administered banking services operations provided by our Guernsey business) were $39.9 billion as at 31 December 2012, up from $39.1 billion the prior year.

Other Non-Interest Income

The components of other non-interest income are set forth in the following table:

	Year ended 31 December	
(in $ thousands)	2012	2011
Net share of earnings from investments in affiliates	**920**	884
Rental income	**3,062**	2,889
Other	**2,233**	1,934
Total other non-interest income	**6,215**	5,707

In 2012, we recorded equity pickup income of $0.9 million, which is consistent with the prior year. Rental income increased by $0.2 million to $3.1 million in 2012 from an increase in rented premises previously occupied by the Bank for its operations. Included in the "Other" category are maintenance fees from leased premises, Director fee income, and other miscellaneous income.

Net Interest Income Before Provision For Loan Losses

Net interest income is the amount of interest earned on our interest-earning assets less interest paid on our interest-bearing liabilities. There are several drivers of the change in net interest income, including changes in the volume and mix of interest-earning assets and interest-bearing liabilities, their relative sensitivity to interest rate movements, and the proportion of non-interest-bearing sources of funds, such as equity and non-interest-bearing current accounts.

The following table presents the components of net interest income for the years ended 31 December 2012 and 2011:

			2012			2011
(in $ millions)	Average balance	Interest	Average rate	Average balance	Interest	Average rate
Assets						
Cash and cash equivalents and short-term investments	1,596.7	5.0	0.3%	1,946.4	9.6	0.5%
Investments	2,551.5	49.1	1.9%	2,452.0	43.8	1.8%
Loans	4,036.0	190.7	4.7%	3,952.1	188.1	4.8%
Interest-earning assets	8,184.2	244.8	3.0%	8,350.5	241.5	2.9%
Other assets	626.3	-	-	754.2	-	-
Total assets	8,810.5	244.8	2.8%	9,104.7	241.5	2.7%
Liabilities						
Deposits	6,305.6	(21.1)	(0.3%)	6,604.1	(28.8)	(0.4%)
Securities sold under agreement to repurchase	8.4	-	-	3.6	-	-
Subordinated capital	261.2	(12.6)	(4.8%)	278.4	(10.4)	(3.8%)
Interest-bearing liabilities	6,575.2	(33.7)	(0.5%)	6,886.1	(39.2)	(0.6%)
Non-interest-bearing current accounts	975.0	-	-	931.1	-	-
Other liabilities	385.6	-	-	452.8	-	-
Total liabilities	7,935.8	(33.7)	(0.4%)	8,270.0	(39.2)	(0.5%)
Shareholders' equity	874.7			834.7		
Total liabilities and Shareholders' equity	8,810.5			9,104.7		
Non-interest-bearing funds net of non-interest earning assets (free balance)	1,609.0			1,464.4		
Net interest margin		211.1	2.58%		202.3	2.42%

Net interest income before provisions for credit losses increased by 4.4% to $211.1 million in 2012 compared to $202.3 million in 2011, of which 61% (2011: 65%) was generated in Bermuda and 21% (2011: 18%) in the Cayman Islands. Average investment yields of 1.9% on $2.6 billion, combined with a 0.1% decrease in deposit cost, drove a 16 basis point improvement in the net interest margin to 2.58% in 2012 compared to 2.42% in 2011. Although average interest-earning assets decreased by $166.3 million to $8.2 billion in 2012, the decrease had a positive impact on net interest income as the decline was driven by the migration of high-cost deposits which were deployed in lower yielding assets in the cash and cash equivalents category. Free balances of $1.6 billion in 2012 (2011: $1.5 billion) include non-interest-bearing current accounts of $1.0 billion (2011: $0.9 billion) and Shareholders' equity of $875 million (2011: $835 million) net of other assets and other liabilities. See the Risk Management section for more information on how interest rate risk is managed.

Provision For Credit Losses

The Bank's net provisions for credit losses in 2012 were $14.2 million compared to $13.2 million in 2011. The Bank anticipates the difficulties in the local economies will continue for the foreseeable future and has made prudent provisions in anticipation of a difficult market. The $20.8 million incremental provisions were required principally for the specific reserves pertaining to commercial and residential exposures offset by a $2.9 million release in the general provision and recoveries of $3.7 million.

Net Gains (Losses)

The following table represents the components of net gains (losses) for the years ended 31 December 2012 and 2011:

(in $ thousands)	**2012**	**2011**
Net realised / unrealised gains (losses) on trading investments	**268**	(919)
Net realised gains on available-for-sale investments	**2,028**	2,058
Net realised / unrealised losses on Other real estate owned	**(2,053)**	-
Gain on sale of affiliates	**4,231**	3,178
Impairment of fixed assets	**(14,527)**	-
Impairment of intangible assets	**(9,143)**	-
Impairment of goodwill	**(9,505)**	-
Net other gains (losses)	**1,389**	(79)
Total net (losses) gains	**(27,312)**	4,238

Net Realised / Unrealised Gains (Losses) on Trading Investments

A $0.3 million gain was recorded with respect to trading securities in 2012 compared to a loss of $0.9 million in 2011, which relates primarily to the fair value adjustments of the Bank's seed money in shares of the Butterfield Select Investment Fund, the Butterfield Select Alternative Fund and the BNY Mellon Butterfield Income Advantage Fund, which was launched in 2011.

Net Realised Gains on Available-For-Sale Investments

Net realised gains of $2.0 million (2011: $2.1 million) were recorded on securities sold in the normal course of business as part of our asset and liability management strategy.

Gain On Sale of Affiliates

In the second quarter of 2012, the Bank sold its 27.8% interest in Island Heritage Holdings Ltd., a Cayman-based insurance company, to BF&M Limited for gross proceeds of $18.5 million, resulting in a gain of $4.2 million. In the second quarter of 2011, the Bank sold its 36% equity interest (on a diluted basis) in BFG for a gain of $3.2 million.

Net Realised / Unrealised Losses on Other Real Estate Owned

Valuation adjustments related to real estate held for sale were $2.1 million compared to nil in 2011.

Impairment of Fixed Assets

The Bank's annual property impairment assessment resulted in the impairment of various properties and a write down of $6.5 million was recorded as the carrying value was not considered recoverable. Additionally, at the end of 2012, the Bank changed its commitment with respect to certain Bermuda properties that were being used in its operations but are now held for sale and, therefore, the properties have been reclassified to Other real estate owned assets in the Consolidated Balance Sheet. The reclassification resulted in an $8 million write down of the carrying amount to its fair value less cost to sell.

Impairment of Goodwill and Intangible Assets

Annual impairment tests of goodwill and intangible assets concluded that the carrying amount of goodwill and intangible assets of our United Kingdom segment was considered fully impaired due to a continuous period of losses incurred and future estimated profitability being unable to sustain current valuations. The intangible asset of the Bahamas segment was impaired as the present value of net cash flows expected to be derived for the remaining customer base is significantly less than the expectations as at the acquisition date. A $9.1 million impairment of intangible assets and a $9.5 million impairment of goodwill were recorded in 2012 compared to nil in 2011.

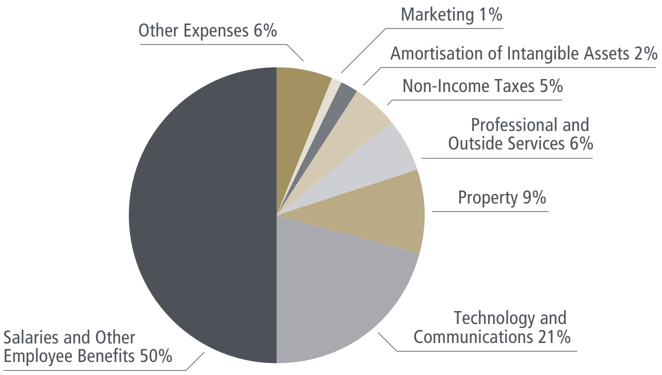
Net Other Gains (Losses)

Net other gains (losses) were $1.4 million in 2012 compared to net other losses of $0.1 million in 2011 and include gains and losses from the sales of fixed assets and other miscellaneous items.

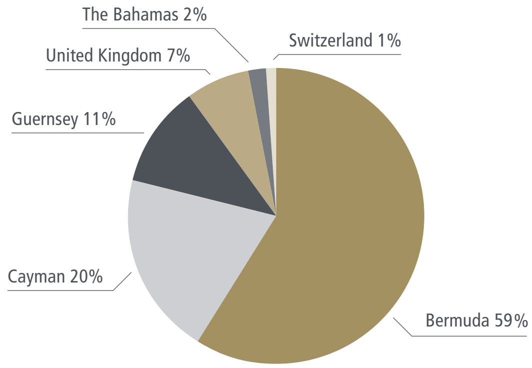
Non-Interest Expenses

Expense management continued to be a key focus of the Bank in 2012 as the challenging economic conditions and persistently low interest rates challenged the banking business model. Total non-interest expenses in 2012 were $274.2 million compared to $286.6 million recorded in 2011. Salary and employee benefits account for 50% of non-interest expenses with technology, communications and property making up 30% combined. Bermuda expenses (including head office costs) represent the majority of the Group costs at 59% of total non-interest expenses.

DISTRIBUTION OF 2012 NON-INTEREST EXPENSES



DISTRIBUTION OF 2012 EXPENSES BY LOCATION



The following table presents the components of non-interest expenses for the years ended 31 December 2012 and 2011:

(in $ thousands)	2012	2011	$ change	% change
Salaries and other employee benefits	**137,433**	145,136	(7,703)	(5.3%)
Technology and communications	**57,715**	53,929	3,786	7.0%
Property	**26,129**	27,080	(951)	(3.5%)
Professional and outside services	**15,409**	18,430	(3,021)	(16.4%)
Non-income taxes	**13,158**	14,029	(871)	(6.2%)
Amortisation of intangible assets	**5,040**	5,367	(327)	(6.1%)
Marketing	**3,963**	4,891	(928)	(19.0%)
Other non-interest expenses	**15,401**	17,766	(2,365)	(13.3%)
Total non-interest expense	**274,248**	286,628	(12,380)	(4.3%)
Income tax expense (benefit)	**5,890**	(306)	6,196	N/A
Total expenses	**280,138**	286,322	(6,184)	(2.2%)

Salaries and Other Employee Benefits

Salaries and other employee benefits decreased by $7.7 million (5.3%) to $137.4 million in 2012 from $145.1 million the prior year. A headcount reduction of 60 drove a $6.8 million reduction in net salary cost offset by an increase of $0.2 million in salaries for temporary contract workers. Additionally, overtime declined by $1.3 million, net pension expense fell by $3.2 million, offset by a $1.5 million increase in staff incentive expense, primarily from vesting of previously issued stock-based compensation, and rising medical costs, up $1.1 million to $7.1 million in 2012. Headcount at the end of 2012 was 1,210, compared to 1,270 a year ago on a full-time equivalency basis.

Technology and Communications

Technology and communication costs were $57.7 million in 2012, up $3.8 million on the $53.9 million recorded in 2011 as a result of increased depreciation costs related to system implementation projects that occurred in Bermuda and Cayman during 2011.

Property

Property costs, which reflect occupancy expenses, building maintenance, and depreciation of property, plant and equipment, decreased by $1.0 million to $26.1 million in 2012 versus $27.1 million in 2011. The decrease was primarily due to improved management of property maintenance costs.

Professional and Outside Services

Professional and outside services primarily include consulting, legal, audit, and other professional services. In 2012, the expense was $15.4 million, down $3.0 million compared to $18.4 million incurred in 2011 from the reduction in the use of consultants and other expense management initiatives.

Non-Income Taxes

These taxes reflect non-income-related taxes levied on us in the various jurisdictions in which we operate, including those associated with employee-related costs such as payroll tax, customs duties and business licences. In 2012, we incurred costs of $13.2 million compared to $14.0 million in 2011; the decrease reflecting lower payroll tax in Bermuda due to a decreased number of employees and decrease in payroll tax rate part way through 2011.

Amortisation of Intangible Assets

Intangible assets relate to client relationships acquired from business acquisitions and are amortised on a straight-line basis over their estimated useful lives, not exceeding 15 years. Acquired intangible assets estimated lives are re-evaluated annually and tested for impairment. The amortisation expense associated with intangible assets was $5.0 million in 2012 compared to $5.4 million in 2011.

Marketing

Marketing expenses reflect costs incurred in advertising and promoting our products and services. They totalled $4.0 million in 2012, down $0.9 million from 2011 and represent 1.2% of total net revenues before gains and losses and provisions for credit losses in 2012 compared to 1.5% in 2011.

Other Non-Interest Expenses

(in $ thousands)	**2012**	**2011**	**$ change**
Stationery & supplies	**1,421**	1,750	(329)
Custodian & handling	**1,417**	1,752	(335)
Charitable donations	**911**	1,235	(324)
Insurance	**2,456**	2,830	(374)
Other expenses			
Maintenance fees for liquidity facility	**306**	357	(51)
Cheque processing	**1,488**	1,615	(127)
Dues and subscriptions	**541**	562	(21)
Registrar and transfer agent fee	**739**	822	(83)
Agent commission fees	**492**	639	(147)
Foreign bank charges	**370**	770	(400)
Directors' fees	**1,021**	811	210
ATM fees	**455**	426	29
General expenses	**1,417**	1,044	373
Other	**2,367**	3,153	(786)
Total other non-interest expenses	**15,401**	17,766	(2,365)

Other non-interest expenses were $15.4 million in 2012, a decrease of $2.4 million compared to 2011, in part due to lower transaction processing fees as a result of lower volumes and cost management initiatives resulting in a reduction in items such as stationery and supplies, insurance costs, and lower operational losses than in the prior year which are included in "other".

Income Taxes

In 2012, income tax expenses associated with our businesses in taxable jurisdictions, namely Guernsey, Switzerland and the United Kingdom, netted to $5.9 million compared to a benefit of $0.3 million in 2011. 2012 taxes reflect a tax expense of $5.0 million (2011: $1.2 million benefit) in the United Kingdom operations and $0.9 million (2011: $0.8 million) in Guernsey. The $5.0 million tax expense in the UK reflects a $4.1 million valuation allowance against deferred income tax assets in addition to a $0.9 million tax adjustment related to prior year.

CONSOLIDATED BALANCE SHEET AND DISCUSSION

The following table shows the Balance Sheet as reported as at 31 December 2012 and 31 December 2011:

(in $ millions)	2012	2011	$ change
Assets			
Cash and cash equivalents	**1,652**	1,903	(251)
Short-term investments	**76**	20	56
Investments	**2,882**	2,062	820
Loans, net of allowance for credit losses	**3,956**	4,069	(113)
Premises, equipment and computer software	**243**	272	(29)
Goodwill and intangibles	**22**	46	(24)
Other assets	**111**	145	(34)
Total assets from continuing operations	**8,942**	8,517	425
Assets of discontinued operations	**-**	307	(307)
Total assets	**8,942**	8,824	118
Liabilities			
Total deposits	**7,502**	7,257	245
Total other liabilities	**323**	197	126
Subordinated capital	**260**	268	(8)
Total liabilities from continuing operations	**8,085**	7,722	363
Liabilities of discontinued operations	**-**	272	(272)
Total liabilities	**8,085**	7,994	91
Preference Shareholders' equity	**196**	200	(4)
Common and Contingent Value Convertible Preference Shareholders' equity	**661**	630	31
Total Shareholders' equity	**857**	830	27
Total liabilities and Shareholders' equity	**8,942**	8,824	118
Capital Ratios			
Risk-weighted assets	**4,275**	4,426	(151)
Tangible common equity (TCE)	**639**	584	55
Tangible assets (TA)	**8,920**	8,471	449
TCE/TA	**7.17%**	6.89%	0.28%
Tier 1 Common Ratio	**13.96%**	13.10%	0.86%
Tier 1 Capital Ratio	**18.53%**	17.70%	0.83%
Total Capital Ratio	**24.18%**	23.50%	0.68%

The Bank maintains a highly liquid Balance Sheet and is well capitalised. At 31 December 2012, total cash and cash equivalents, short-term investments and investments represented $4.6 billion, or 51.5% of total assets, up from 46.8% at year-end 2011 before discontinued operations. The Bank's Balance Sheet remains strong, with Shareholders' equity ending the year up $27 million to $857 million of which $196 million is 8% Preference Shareholders' equity and $661 million is common equity. Total assets grew by $118 million to $8.9 billion, but when adjusted for the $307 million of assets from discontinued operations in the prior year, total assets grew by $425 million primarily reflecting a $245 million increase in deposits, $109 million of funding from repurchase agreements, and a $27 million increase in Shareholders' equity. At 31 December 2012, Butterfield's capital ratios were strong, having improved from year-end 2011, with the TCE/TA Ratio ending 2012 at 7.17% (2011: 6.89%), whilst the Total Capital Ratio and Tier 1 Capital Ratio were 24.18% (2011: 23.50%) and 18.53% (2011: 17.70%) respectively. These Ratios are well in excess of regulatory minimums.

Cash, Cash Equivalents and Short-Term Investments

The Bank only places deposits with highly rated institutions and ensures there is appropriate geographic diversification in its exposures. Limits are set for aggregate geographic exposures for each institution and are monitored and reviewed by our Credit Risk Management ("CRM") division and approved by the Financial Institutions Committee. Effective 1 January 2011, the Bank changed its accounting policy with respect to cash and cash equivalents for the purposes of the Consolidated Statement of Cash Flows. The Bank defines cash and cash equivalents to include cash on hand, cash items in the process of collection, amounts due from correspondent banks and highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of change in fair value. Such investments are those with less than three months maturity from the date of acquisition and include unrestricted term deposits, certificates of deposit and Treasury bills. Investments of a similar nature that are either restricted or have a maturity of more than three months but less than one year are classified as short-term investments. Previously, cash and demand deposits with banks only included cash and demand deposits, vault cash and cash in transit for the purposes of the Consolidated Statement of Cash Flows. The new policy more closely reflects the manner in which the Bank manages its liquid assets. As at 31 December 2012, cash and cash equivalents and short-term investments were $1.7 billion, compared to $1.9 billion as at 31 December 2011.

See "Note 4: Cash and cash equivalents" in the 31 December 2012 Consolidated Financial Statements for additional tables and information.

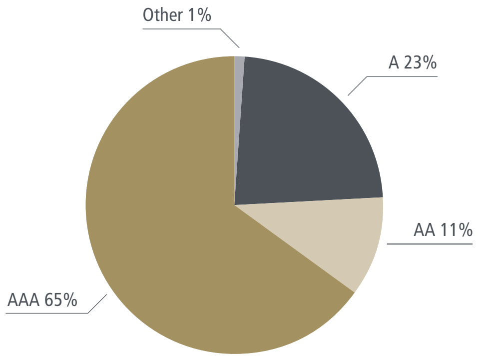
Investments

Our investment policies require Management to maintain a portfolio of securities that will provide the liquidity necessary to facilitate the funding of loans and cover deposit fluctuations, and to mitigate our overall Balance Sheet exposure to interest rate risk, whilst achieving a satisfactory return on the funds invested. The securities in which we may invest are limited to securities that are considered investment grade. Securities in our investment portfolio are accounted for under US GAAP as either trading, available for sale or held to maturity. Investment policies are approved by the Board of Directors, governed by the Group Asset and Liability Management Committee and monitored daily by Group Market Risk, a department of the Group Risk Management division.

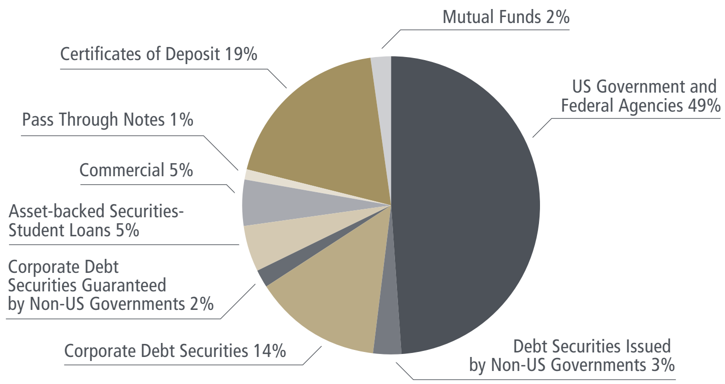
Effective 1 October 2010, the Bank entered into an investment advisory agreement with Carlyle Investment Management LLC, an affiliated company of the Carlyle Group. Under the agreement, Carlyle provided Balance Sheet management advisory services to the Bank including, but not limited to: development of investment strategies for consideration by the Bank's Asset and Liability Committee; Balance Sheet simulation analysis, including interest rate sensitivity, economic value at risk, interest at risk and stress testing; detailed investment portfolio reporting; cash flows and net interest income forecasting; deposit behaviour analysis and pricing strategies; and assistance with credit advisory and workout strategies. Effective 31 July 2012, the investment advisory business previously conducted by Carlyle Investment Management LLC was transferred to Alumina Investment Management LLC ("Alumina") and the Bank agreed to the transfer of its contract to Alumina.

As at 31 December 2012, 99% (2011: 98%) of our total investments were rated investment grade (i.e., rated "BBB" or higher).

31 DECEMBER 2012 INVESTMENT PORTFOLIO BY LONG-TERM DEBT RATING



31 DECEMBER 2012 INVESTMENT PORTFOLIO BY TYPE



The following table presents the carrying value of investments by Balance Sheet category:

	As at 31 December		
(in $ millions)	**2012**	**2011**	**$ change**
Trading	**62**	63	(1)
Available for sale	**2,581**	1,934	647
Held to maturity	**239**	65	174
Total investments	**2,882**	2,062	820

Total investments were $2.9 billion as at 31 December 2012, up $0.8 billion from the prior year-end balance, due primarily to the sale of the majority of our European exposures in the fourth quarter of 2011 and the purchase of treasury securities, which are included in the cash and cash equivalents category.

Trading securities, consisting of holdings of non-US government securities, corporate equities and seed money invested in mutual funds managed by us, totalled $62 million at year-end 2012, compared to $63 million at year-end 2011. Trading securities primarily reflect the $50 million initial seed money invested by the Bank in BNY Mellon Butterfield Income Advantage Fund and $7 million invested in other Butterfield Select Funds totalling $57 million, classified as equities in the table below.

Available-for-sale ("AFS") securities totalled $2.6 billion at year-end 2012, compared to $1.9 billion at year-end 2011. As at 31 December 2012, 45.7% or $1.2 billion (2011: 40.9% or $0.8 billion) of AFS securities consisted of holdings of mortgage-back securities issued by US government and federal agencies. Corporate debt securities, certain of which are guaranteed by non-US governments totalled 17.6%, or $453 million (2011: 27.2% or $527 million), and certificates of deposit represented 21.8% or $561 million (2011: 18.4% or $356.5 million). The remaining 15.0% of AFS securities is comprised primarily of commercial mortgage-backed securities ($130 million), government guaranteed student loan-backed securities ($136 million), debt securities issued by non-US governments ($90 million), and one pass-through note ("PTN") ($31 million), which was formerly a structured investment vehicle ("SIV").

Held-to-maturity ("HTM") investments were $239 million as at 31 December 2012 (2011: $65 million) and consisted entirely of mortgage-backed securities issued by US government agencies that Management has no intention to sell before maturity.

Investment Valuation

Securities in unrealised loss positions are analysed as part of Management's ongoing assessment of Other-Than-Temporary Impairment ("OTTI"). When Management intends to sell securities, it recognises an impairment loss equal to the full difference between the amortised cost basis and the fair value of those securities. When Management does not intend to sell equity or debt securities in an unrealised loss position, potential OTTI is considered using a variety of factors, including the length of time and extent to which the market value has been less than amortised cost; adverse conditions specifically related to the industry, geographic area or financial condition of the issuer or underlying collateral of a security; payment structure of the security; changes to the rating of the security by a rating agency; the volatility of the fair value changes; and changes in fair value of the security after the Balance Sheet date.

For debt securities, Management estimates cash flows over the remaining lives of the underlying collateral to assess whether credit losses exist and to determine whether any adverse changes in cash flows have occurred. Management's cash flow estimates take into account expectations of relevant market and economic data, such as GDP and unemployment, during the cash flow cycle as of the end of the reporting period and includes, for example, underlying loan-level data, and structural features of securitisation, such as subordination, excess spread, over-collateralisation or other forms of credit enhancement. Management compares the losses projected for the underlying collateral ("pool losses") against the level of credit enhancement in the securitisation structure to determine whether these features are sufficient to absorb the pool losses, or whether a credit loss on the debt security exists. Management also performs other analyses to support its cash flow projections, such as stress scenarios. For debt securities, Management considers a decline in fair value to be other-than-temporary when it does not expect to recover the entire amortised cost basis of the security.

See "Note 6: Investments" in the 31 December 2012 Consolidated Financial Statements for additional tables and information.

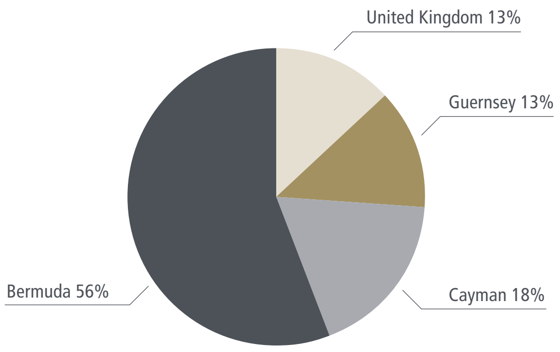
Loans

The loan portfolio stood at $4.0 billion at 31 December 2012, down $0.1 billion from $4.1 billion the year before, primarily due to the repayment of a Bermuda Government loan of $226 million and an increase in European mortgages of $180.3 million. At 31 December 2012, the loan portfolio represented 44.2% of total assets, compared to (47.8%) at 31 December 2011, whilst loans as a percentage of customer deposits were 53.6% (2011: 57.1%).

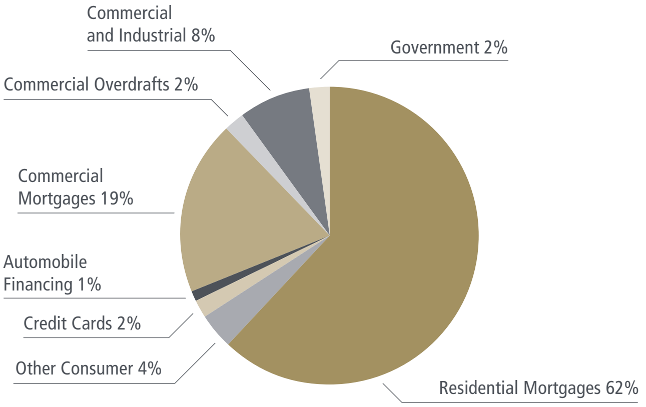
Allowance for credit losses at 31 December 2012 totalled $56.0 million, an increase of $0.5 million from 2011. The movement in the allowance is mainly the result of additional provisions, before recoveries, of $18.3 million taken during 2012 net of $17.8 million in charge-offs. Of the total allowance, the general allowance was $29.2 million (2011: $32.0 million) and the specific allowance was $26.7 million (2011: $23.5 million), reflecting an improved specific coverage ratio of 23.6%, up from 21.3% at 31 December 2011.

Gross non-accrual loans totalled $113.4 million at 31 December 2012, down $3.2 million from $110.1 million at 31 December 2011, and represented 2.8% of the total loan portfolio at 31 December 2012, compared to 2.7% in 2011. During 2012, the Bank held Other Real Estate Owned properties ("OREO") amounting to $34.4 million comprising commercial real estate of $19.3 million, foreclosed residential properties of $7.6 million and property held for sale reclassified during 2012 of $7.5 million.

31 DECEMBER 2012 LENDING BY LOCATION



31 DECEMBER 2012 GROUP LOANS BY TYPE



Commercial and Industrial

Government

Loans to governments decreased by $192.1 million, primarily as a result of the repayment of a Bermuda Government loan facility.

Commercial

The commercial and industrial loan portfolio includes loans and overdraft facilities advanced primarily to corporations and small and medium-sized entities, which are generally not collateralised by mortgages and where loan repayments are expected to flow from the operation of the underlying businesses.

Commercial mortgages are offered to real estate investors, developers and builders domiciled primarily in Bermuda and the United Kingdom. To manage our credit exposure on such loans, the principal collateral is real estate held for commercial purposes and is supported by a registered mortgage. Cash flows from the properties, primarily from rental income, are generally supported by long-term leases to high quality international businesses. These cash flows are principally sufficient to service the loan.

Commercial loans of $1.2 billion at 31 December 2012 decreased by $33.6 million from the previous year, primarily due to repayments of certain commercial lending facilities which were offset by advancing corporate loans.

Residential

The residential mortgage portfolio comprised of mortgages to clients with whom we are seeking to establish (or already have) a comprehensive financial services relationship. It includes mortgages to individuals and corporate loans secured by residential property.

At 31 December 2012, residential mortgages totalled $2.5 billion (or 62.2% of total gross loans), an increase of $166.5 million from 31 December 2011. Our Guernsey and United Kingdom offices increased residential mortgage lending to high net worth individuals, secured by high-end properties in the London, UK area, during the year, resulting in a $180.3 million increase in non-Bermuda residential mortgages in the portfolio.

All mortgages were underwritten utilising our stringent credit standards. Residential loans consist of conventional home mortgages and equity credit lines.

Other Loan Portfolios

We provide loans, as part of our normal banking business, in respect of automobile financing, consumer financing, credit cards, commercial financing, loans to financial institutions and overdrafts facilities to retail, corporate and private banking clients in the jurisdictions in which we operate.

Our loan portfolio and contractual obligations and arrangements are discussed in more detail in "Note 7: Loans" and "Note 8: Credit Risk Concentrations" in the 31 December 2012 Consolidated Financial Statements.

Deposits

Deposits are our principal funding source for use in lending, investments and liquidity. Butterfield is a deposit-led Bank and does not require the use of wholesale funding to fund its loan business. Deposit balances at the end of reporting periods, particularly in our Bermuda and Cayman Islands operations, can fluctuate due to significant balances that flow in and out from hedge fund clients to meet quarter-end subscriptions and redemptions, and are generally paid out in the first few days of the quarter. The table below shows the year-end and average customer deposit balances by jurisdiction, comparing 2012 with 2011:

	Year ended 31 December			Average balance		
(in $ millions)	2012	2011	$ change	2012	2011	$ change
Bermuda	3,364	3,260	104	3,209	3,340	(131)
Cayman	1,862	1,743	119	1,791	1,732	59
Guernsey	1,370	1,334	36	1,389	1,465	(76)
The Bahamas	70	59	11	62	92	(30)
UK	709	735	(26)	730	814	(84)
Total average deposits	7,375	7,131	244	7,181	7,443	(262)

Customer deposit balances increased $244 million from $7.1 billion as at 31 December 2011 to $7.4 billion as at 31 December 2012. The average balance of $7.2 billion in 2012 fell compared to 2011 as deposit balances started 2011 higher and ended lower, which reverses in 2012, rising in the latter part of the year particularly in Bermuda, Cayman and Guernsey.

Customer demand deposits, which include chequing accounts (both interest-bearing and non-interest-bearing), savings and call accounts, totalled $5.4 billion, or 73.7% of total customer deposits at year-end 2012, compared to $5.0 billion, or 70.0%, at year-end 2011. Customer term deposits decreased by 9.2% from $2.1 billion at year-end 2011 to $2.0 billion at year-end 2012 as customers moved to demand deposits given the low interest rate spread on longer-term deposits.

The cost of funds was 0.34% in 2012, down 10 basis points from the 0.44% paid in 2011 as a result of disciplined deposit pricing that contributed to the improvement in net interest income.

See "Note 11: Customer Deposits and Deposits from Banks" in the 31 December 2012 Consolidated Financial Statements for additional tables and information.

Borrowings

We have no issuances of certificates of deposit ("CD"), commercial paper ("CP") or senior notes outstanding and have no CD or CP issuance programmes. We are able to source funding on an uncommitted basis from a number of major banks, including our principal correspondent banks. We use funding from the inter-bank market as part of interest rate and liquidity management. At 31 December 2012, deposits from banks totalled $126 million, the same as the prior year.

Employee Future Benefits

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

Effective 31 December 2011, the Bermuda Defined Benefit pension benefits were amended to freeze credited service and final average earnings for remaining active members. Effective January 2012, all the participants of the Bermuda Defined Benefit Pension Plan are inactive and in accordance with US GAAP, the net actuarial loss of the Bermuda Defined Benefit Pension Plan is amortised over the estimated average remaining life expectancy of the inactive participants of 22.8 years. Prior to all Bermuda participants being inactive, the net actuarial loss of the Bermuda Defined Benefit Pension Plan was amortised to net income over the estimated average remaining service period for active members of 4.5 years.

As at 31 December 2012, the Bank had a substantial obligation for employee future benefits in the amount of $103 million, down $2 million from $105 million at year-end 2011.

See "Note 12: Employee Future Benefits" in the 31 December 2012 Consolidated Financial Statements for additional tables and information.

Subordinated Debt, Interest Payments and Maturities

We have outstanding issuances of subordinated debt with a carrying value of $260 million as at 31 December 2012, all issued in US dollars, compared to $267.8 million as at 31 December 2011. All but $45.0 million of outstanding subordinated debt is eligible for inclusion in our Tier 2 regulatory capital base and is limited to 50% of Tier 1 capital.

During September 2011, the Bank repurchased a portion of the outstanding 5.11% 2005 Series B Subordinated Notes ("the Note"). The Note had a face value of $15.0 million which was repurchased for $13.87 million, netting a gain of $1.13 million. On 9 February 2012, the Bank redeemed the 9.29%, £5.0m ($7.9 million) subordinated debt note issued by our United Kingdom operation.

The following table presents the contractual maturity, interest rates and principal outstanding as at 31 December 2012:

Subordinated capital	Earliest date redeemable	Contractual maturity date	Interest rate until date redeemable	Interest rate from earliest date redeemable to contractual maturity	Principal outstanding
2003 issuance - Series B	27 May 2013	27 May 2018	5.15%	3 months US$ LIBOR + 2.000%	47,000
2005 issuance - Series A	2 July 2010	2 July 2015	4.81%	3 months US$ LIBOR + 1.095%	90,000
2005 issuance - Series B	2 July 2015	2 July 2020	5.11%	3 months US$ LIBOR + 1.695%	45,000
2008 issuance - Series A	27 May 2013	27 May 2018	7.59%	3 months US$ LIBOR + 4.185%	53,000
2008 issuance - Series B	27 May 2018	27 May 2023	8.44%	3 months US$ LIBOR + 4.929%	25,000
Total					260,000

See "Note 19: Subordinated Capital" in the 31 December 2012 Consolidated Financial Statements for additional information.

Repurchase Agreements

We also obtain funds from time to time from the sale of securities to institutional investors under repurchase agreements. In a repurchase agreement transaction, we will generally pledge investment securities as collateral in a borrowing transaction, agreeing to repurchase the identical security on a specified later date, generally not more than 90 days, at a price greater than the original sales price. The difference between the sale price and repurchase price is the cost of the use of the proceeds, or interest expense. The investment securities underlying these agreements may be delivered to securities dealers who arrange such transactions as collateral for the repurchase obligation. Repurchase agreements represent a cost competitive funding source and also provide liquidity on agency paper for us. However, we are subject to the risk that the borrower of the securities may default at maturity and not return the collateral. In order to minimise this potential risk when entering into such transactions, we generally deal with large, established investment brokerage firms with whom we have Master Repurchase Agreements. Repurchase transactions are accounted for as financing arrangements rather than as sales of such securities, and the obligation to repurchase such securities is reflected as a liability in our Consolidated Financial Statements. As at 31 December 2012, $109.0 million of repurchase agreements were outstanding compared to nil the year before. US government and federal agency investment securities with an amortised cost of $120.9 million and fair market value of $122.4 million were pledged to secure repurchase agreements at 31 December 2012.

Shareholders' Equity

Shareholders' equity increased during the year ended 31 December 2012 by $27.4 million to $857.2 million, reflecting:

- $25.6 million net income for the year
- $43.1 million from unrealised gains on AFS securities
- $5.5 million of Share-based compensation
- $0.8 million translation adjustments on foreign operations

These increases were offset by:

- $15.2 million net increase in employee future benefits from the decline in interest rates used to discount the future cash flows, and lower than expected return on plan assets
- $18.0 million Preference Share dividends and guarantee fee
- $5.4 million from the buy-back and cancellation of Preference Shares
- $9.0 million from the purchase of Treasury Common Shares

Capital Resources

One of Management's primary objectives is to maintain a strong capital base to promote confidence in the Bank among our clients, the investing public, bank regulators, rating agencies, and Shareholders. The Bank manages its capital both on a total Group basis and, where appropriate, on a legal entity basis. The Finance department has the responsibility for measuring, monitoring and reporting capital levels within guidelines and limits established by the Risk Policy & Compliance Committee of the Board. The management of capital will also involve regional Management to ensure compliance with local regulation. In establishing the guidelines and limits for capital, a variety of factors are taken into consideration, including the overall risk of the business in stressed scenarios, regulatory requirements, capital levels relative to our peers, and the impact on our credit ratings.

The Bank is subject to Basel II which is a risk-based capital adequacy framework developed by the Basel Committee on Banking Supervision and has been endorsed by the central bank governors and heads of bank supervision of the G10 countries. The Bank calculates its capital requirement on the standardised approach under Basel II requirements. The Bank does not expect the changes being proposed to the capital adequacy ratios under Basel III to have a material impact on the Bank's capital ratios.

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

As at 31 December 2012, the Bank's regulatory capital stood at $1.0 billion with the consolidated Tier 1 and Total Capital Ratios of 18.5% and 24.2% respectively (31 December 2011: 17.7% and 23.5% respectively).

The following table sets forth our capital adequacy as at 31 December 2012 and 31 December 2011 in accordance with Basel II framework:

	Year ended 31 December	
(in $ millions)	**2012**	**2011**
Capital		
Tier 1 Capital	**792.3**	781.4
Tier 2 Capital	**244.2**	276.3
Deductions	**(2.9)**	(16.7)
Total Capital	**1,033.6**	1,041.0
Weighted Risk Assets		
Cash and cash equivalents and investments	**913.8**	722.7
Loans	**2,232.3**	2,408.7
Other assets	**350.7**	401.7
Off-Balance Sheet items	**261.7**	320.2
Operational risk charge	**516.5**	572.3
Total weighted risk assets	**4,275.0**	4,425.6
Capital Ratios (%)		
Tier 1 Common	**14.0%**	13.1%
Tier 1 Total	**18.5%**	17.7%
Total Capital	**24.2%**	23.5%

Under Basel II Pillar III (market disclosure) the Bank is required to publish further information about the risks to which it is exposed. The Bank's Pillar III disclosures for the year ended 31 December 2012 will be published on the corporate website, www.butterfieldgroup.com, shortly after the publication of the Consolidated Financial Statements.

Preference Shares (See the *Offering Memorandum* for details)

In June 2009, the Bank offered 200,000 of 8.00% Non-Cumulative Perpetual Limited Voting Preference Shares, liquidation preference of US $1,000 per share (the "Preference Shares") and $200,000,000 in the aggregate. The Preference Shares are fully and unconditionally guaranteed, with the full faith and credit of the Government of Bermuda (the "Guarantor"), as to payment of dividends for up to ten years and as to payment of the liquidation preference on, or in certain circumstances prior to, the ten-year anniversary of the date of issuance (the "Guarantee").

Dividends on the Preference Shares are payable quarterly on a non-cumulative basis, only when, as and if declared by our Board of Directors, on 15 March, 15 June, 15 September and 15 December of each year at a fixed rate equal to 8.00% per annum on the liquidation preference, commencing on 15 September 2009. In the event that, during the ten-year term of the Guarantee, the Bank does not pay full dividends in respect of any quarterly dividend period on any Preference Shares that are then issued and outstanding, the Guarantor has agreed to pay to holders of the Preference Shares an amount equal to such unpaid dividends pursuant to the Guarantee.

The Bank may redeem the Preference Shares at its option, subject to approval of the Bermuda Monetary Authority ("BMA"), in whole or in part, on the tenth day prior to the ten-year anniversary of the date of issuance (the "Bank Redemption Date"), at a redemption price equal to 100% of the liquidation preference thereof plus any unpaid dividends for the then-current dividend period to the Guarantee End Date, regardless of whether any dividends are actually declared for such dividend period. In addition, the Bank may redeem the Preference Shares prior to the Bank Redemption Date, at its option, subject to approval of the BMA, in whole or in part, at any time and from time to time, at a redemption price equal to the "Make-Whole Redemption Price". Unless previously redeemed, the Guarantor has agreed to purchase from the holders thereof, and such holders will be required to transfer to the Guarantor, on the ten-year anniversary of the date of issuance, all Preference Shares then issued and outstanding, at a price per Preference Share equal to the liquidation preference thereof plus any unpaid dividends for the then-current dividend period to the date of such purchase, regardless of whether any dividends are actually declared for such dividend period. In addition, upon the occurrence of a Liquidation Event at any time prior to the ten-year anniversary of the date of issuance of the Preference Shares, the Guarantor has agreed to purchase from the holders thereof, and such holders will be required to transfer to the Guarantor, all Preference Shares then issued and outstanding, at a price per Preference Share equal to the liquidation preference thereof plus any unpaid dividends for the then-current dividend period to the date of payment, regardless of whether any dividends are actually declared for such dividend period.

Contingent Value Convertible Preference Shares ("CVCP Shares") (See the *Rights Offering Prospectus* for details)

In March 2010, the Bank offered up to 99.3 million Common Shares and 8.3 million CVCP Shares in the form of up to 107.6 million Rights Units, each Unit consisting of 0.92038 Common Shares and 0.07692 CVCP Shares, for each Common Share held at a price of BD$1.21 per Rights Unit.

A holder of CVCP Shares has the option to convert any such Shares to Common Shares at any time. All CVCP Shares outstanding will automatically convert into Common Shares at the earlier of 31 March 2015 or a sale of the Bank. On such conversion, the CVCP Shares will convert into Common Shares at the Conversion Price. The initial Conversion Price shall be US$1.21 subject to any customary anti-dilution adjustments and certain downward notional adjustment based on certain Loan Recoveries.

A holder of CVCP Shares is entitled to certain distributions in connection with certain sales or public offerings of the Bank's equity interest in BFG. On 9 February 2011, the Bank announced that it had agreed to sell its minority ownership position in BFG. The sale transaction closed during the second quarter of 2011 and generated proceeds of $3.31 million. The completion of the sale triggered a dividend of $3.27 million ($0.42 per share) to holders of Butterfield CVCP Shares, which was paid on 16 August 2011 to Shareholders of record on 26 July 2011. Through this transaction, the Bank has fully divested itself of its minority ownership stake in BFG. The Bank continues to provide BFG and its clients with commercial banking, foreign exchange and custody services. BFG was originally established in 2008 through the merger of Butterfield Fund Services and the Fulcrum Group.

When, as and if declared by the Board, holders of the outstanding CVCP Shares will be entitled to receive dividends based on the number of Common Shares into which the CVCP Shares would be convertible as of the dividend record date.

In the event of any voluntary or involuntary liquidation, dissolution or winding up of the affairs of the Bank, the holders of the CVCP Shares will be entitled to receive from its assets legally available for distribution to Shareholders as a liquidation preference before any distribution of assets is made to or set aside for the holders of any junior shares, such as the Common Shares, the greater of (1) US$1.21 per CVCP Share plus any declared but unpaid dividends with respect to the then-current dividend period and (ii) the amount per CVCP Share that would be received if such CVCP Share had converted into Common Shares immediately prior to such liquidation, dissolution or winding up.

The CVCP Shares are issued as perpetual securities subject to conversion to Common Shares and shall not be redeemable by any holders at any time.

The holders of the CVCP Shares will vote together with the holders of the Common Shares on all matters upon which the holders of the Common Shares are entitled to vote. The CVCP Shares shall be entitled to such number of votes based on the number of Common Shares into which the CVCP Shares are convertible as of the applicable record date.

The class vote of the holders of at least 66.6% of the CVCP Shares shall be required for (i) the creation or issuance of shares that are senior to liquidation, (ii) an amendment of rights of the CVCP Shares or (iii) a reclassification, merger, amalgamation or consolidation where the holders of CVCP Shares would not receive the consideration that would be received if such CVCP Shares had converted into Common Shares immediately prior to such event.

The CVCP Shares shall be privately transferable (subject to applicable securities laws and any required regulatory consents) but shall not be listed on the Bermuda Stock Exchange or any other stock exchange. The CVCP Shares will not be registered under the securities laws of any jurisdiction. This will result in limited market for the CVCP Shares. CVCP Shares are transferable to Common Shares at the holders' option by contacting the Bank's transfer agent and registrar.

With respect to the 8.0% Preference Shares, the CVCP Shares rank pari passu as to liquidation and pari passu as to dividends and, with respect to Common Shares, the CVCP Shares rank senior as to liquidation and pari passu as to dividends (other than dividends relating to BFG, as to which the CVCP Shares rank senior).

As at 31 December 2012, there were 7.3 million CVCP Shares outstanding with 0.2 million Shares converted to Common Shares at the holders' option during the year ended as at 31 December 2012. As at 31 December 2012, there were no loan recoveries attributable to the CVCP Shares as defined in the certificate of designation. Consequently, the conversion factor to Common Shares at 31 December 2012 remained one to one (1:1). Loan recoveries mean the amount by which the cumulative amount of collections actually received by the Bank with respect to "Covered Loans" from and after 1 January 2010 and through (and including) the Measurement Date exceeds $102.3 million. In no event shall the loan recoveries exceed US$42.0 million. As at 31 December 2012, the carrying value of the covered loans was $26.9 million (2011: $27.9 million) reflecting charge-offs during the year as approved by the Audit Committee and reviewed by an independent committee of the Board of Directors.

Share Buy-Back Programme

The Bank introduced a Share Buy-Back Programme on 1 May 2012 as a means to improve Shareholder liquidity and facilitate growth in Share value. Under the Bank's Share Buy-Back Programme, the Board authorised the buy-back of up to 6 million Common Shares and 2,000 Preference Shares. On 10 December 2012, the Board approved an increase in the authorised number of Shares to be bought back to 10 million Common Shares and 8,000 Preference Shares. During 2012 the Bank bought back 7.3 million Common Shares to be held as Treasury Shares at an average price of $1.23 per Share (totalling $9.0 million) and 4,422 Preference Shares which were subsequently cancelled at a cost of $5.4 million.

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

The BSX must be advised monthly of Shares bought back and cancelled by the Bank and Shares purchased by the Bank's Stock Option Trust.

Warrants

Following the capital raise on 2 March 2010, the terms of the 4,279,601 warrants with an exercise price of $7.01 previously issued to the Government of Bermuda in conjunction with the issuance of the Preference Shares in 2009 were adjusted in accordance with the terms of the guarantee. Subsequently, the Government of Bermuda now holds 4,150,774 warrants with an exercise price of $3.614 and an expiration date of 22 June 2019.

Dividends

No Common dividends were declared or paid in 2012 or 2011. Preference Share dividends declared and paid were $16.0 million during 2012 (2011: $16.0 million in relation to the Preference Shares). In 2011, a $3.3 million dividend was paid to holders of CVCP Shares triggered by the sale of the Bank's minority interest in BFG. Guarantee fees paid to the Government of Bermuda were $2.0 million during each of 2012 and 2011. Subsequent to year end, the Board declared a special dividend of $0.04 per Common Share and Contingent Value Convertible Preference Share to be paid on 22 March 2013 to Shareholders of record on 5 March 2013.

Cash Flows

Cash and cash equivalents were $1.7 billion as at 31 December 2012, compared to $1.9 billion the prior year. The decrease is described below by category of operating, investing and financing activities.

For the year ended 31 December 2012, net cash provided by operating activities totalled $132.9 million (2011: $39.4 million). Cash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of net income. Cash provided by operating activities increased by $93.5 million from 2011 to 2012, due primarily from the $50 million investment of seed money in the new BNY Mellon Butterfield Income Advantage Fund in 2011, classified as "trading investments" for accounting purposes. However, cash generated from operating activities before changes in trading investments increased $48.0 million from rising core earnings generating higher cash earnings compared to the prior year.

Our investing activities include capital expenditures, loan activities, investment activities, and divesture and acquisition activities. We do not own, directly or indirectly, any shares of stock or any other equity interest or long-term debt securities of any company, corporation, firm, partnership, joint venture, association or other entity, except pursuant to the ordinary course of investment activities, the strategic investment in an associated company or as a result of the ordinary course loan structuring. Net cash used by investing activities for the year ending 31 December 2012 totalled $627.4 million compared to cash provided by investing activities of $238.0 million in 2011. The $865.4 million decrease in 2012 over 2011 was mainly due to a $757.7 million net cash used to purchase HTM and AFS investments, compared to $530.6 million in net investment proceeds in 2011, offset by the movement in loans year over year (2012: net repayment of $137.1 million; 2011: net advances of $261.4 million).

Net cash provided from financing activities totalled $217.9 million in 2012, compared to net cash used in financing of $765.7 million in 2011. The $983.6 million change reflects the net cash used to fund deposit decreases of $730.6 million in 2011, compared to the $149.2 million increase in deposits and $109.0 million increase in repurchase agreements in 2012 offset by the $14.4 million of Share buy-backs and $7.9 million of subordinated debt repayments.

OFF BALANCE SHEET ARRANGEMENTS

Assets Under Administration And Assets Under Management

The Bank, in the normal course of business, holds assets under administration and assets under management in a fiduciary or agency capacity for our clients. In accordance with US GAAP, these assets are not assets of the Bank and are not included in our Consolidated Balance Sheet.

Credit-Related Arrangements

We enter into standby letters of credit, letters of guarantee and contractual commitments to extend credit in the normal course of business, which are not required to be recorded on the Balance Sheet. Since many commitments expire unused or only partially used, these totals do not necessarily reflect future cash requirements. Management believes there are no material commitments to extend credit that represent risks of an unusual nature.

Standby letters of credit and letters of guarantee are issued at the request of our clients in order to secure a client's payment or performance obligations to a third party. These guarantees represent our irrevocable obligation 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 client. Generally, the term of the standby letters of credit does not exceed one year, whilst the term of the letters of guarantee does not exceed four years.

Credit risk is the principal risk associated with these instruments. The contractual amounts of these instruments represent the credit risk should the instrument be fully drawn upon and the client defaults. To control the credit risk associated with issuing letters of credit and letters of guarantee, we subject such activities to the same credit quality and monitoring controls as our lending activities. The types and amounts of collateral security we hold for these standby letters of credit and letters of guarantee is generally represented by our deposits or a charge over assets held in mutual funds. We are obligated to meet the entire financial obligation of these agreements and in certain cases are able to recover the amounts paid through recourse against the collateral security.

The following table sets forth the outstanding financial guarantees with contractual amounts representing credit risk:

As at 31 December			2012			2011
(in $ millions)	Gross	Collateral	Net	Gross	Collateral	Net
Standby letters of credit	**280.1**	**277.3**	**2.8**	321.0	303.8	17.2
Letters of guarantee	**11.2**	**8.7**	**2.5**	13.1	9.9	3.2
Total	**291.3**	**286.0**	**5.3**	334.1	313.7	20.4

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

Contractual Obligations (Including Subordinated Debt)

We enter into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. These credit arrangements are subject to our normal credit standards and collateral is obtained where appropriate. Substantially all of our commitments to extend credit are contingent upon clients 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.

In the second quarter of 2011, the Bank cancelled its commitment for a $300 million line of credit with CIBC as Management deemed it was no longer necessary. Whilst outstanding, the facility fees were $200,000 per month. A $150.0 million committed line of credit to our Bank in the Cayman Islands, from one of its custodians, was allowed to expire on its maturity on 31 December 2011. Both committed lines were exited as they were no longer required as part of the Bank's liquidity management programme.

Effective 1 October 2010, the Bank had retained Carlyle Investment Management LLC, an affiliated company of the Carlyle Group, to provide Balance Sheet management advisory services, including advisory services on valuation assignments, for an annual fee of $4 million for a three-year period. Effective 31 July 2012, the investment advisory business previously conducted by Carlyle Investment Management LLC was transferred to Alumina Investment Management LLC ("Alumina") and the Bank agreed to the transfer of its contract to Alumina.

The Bank has a facility, by one of its custodians, whereby the Bank may offer up to $200 million of standby letters of credit to its customers on a fully secured basis. Under the standard terms of the facility, the custodian has the right to set-off against securities held of 110% of the utilised facility. At 31 December 2012, $137.0 million (2011: $137.1 million) of standby letters of credit were issued under this facility. The contractual amounts for these commitments represent the maximum payments we would have to make should the contracts be fully drawn, the counterparty default, and any collateral held prove to be of no value. Commitments, when drawn, would be funded from our free cash resources.

We enter into other contractual obligations in the normal course of business. Certain of these obligations, such as subordinated debt, are recorded as liabilities in our Consolidated Balance Sheet. Other items, such as sourcing agreements, operating leases and other purchase contracts, are not required to be recorded on the Balance Sheet. Expected cash payments associated with subordinated debt are based on principal payment dates.

See "Note 19: Subordinated Capital" in the 31 December 2012 Consolidated Financial Statements for terms of subordinated debt arrangements and interest obligations.

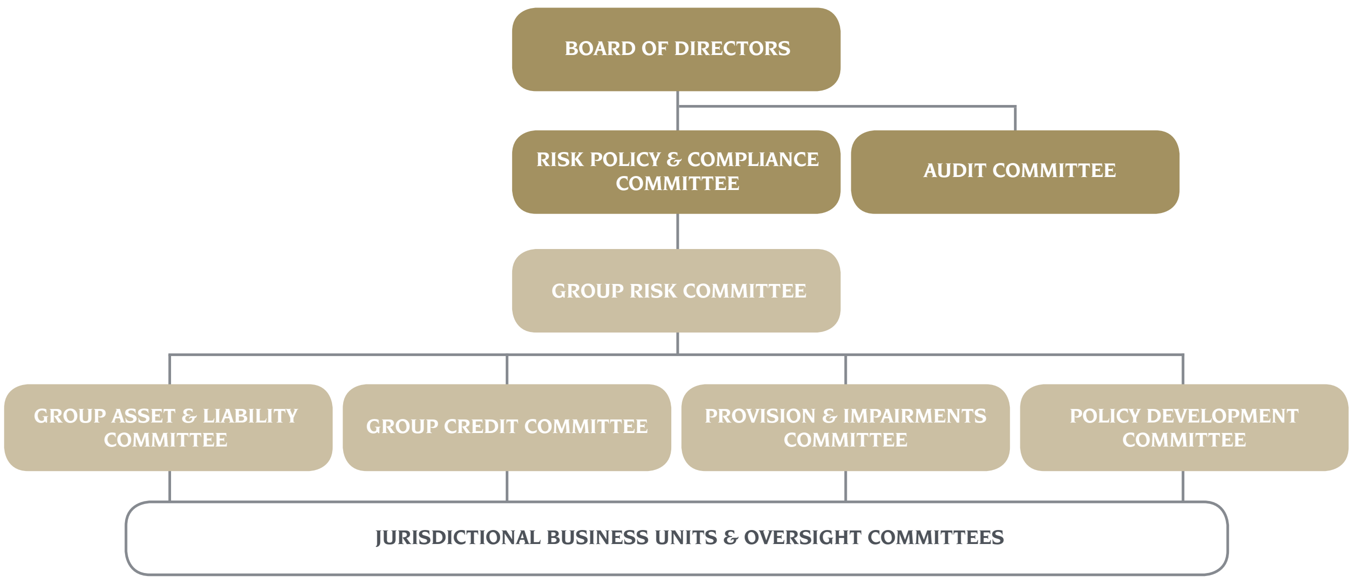
The $75.4 million contractual obligation in respect of sourcing—for Bermuda and the Cayman Islands— relates to an eight-year agreement entered into in October 2008 with global technology service provider Hewlett Packard ("HP") (previously EDS) to supply technology infrastructure and application development management, information security and technical support for our locations in Bermuda and the Cayman Islands. In 2011, working with HP, we completed the transition of all our business applications and legacy systems in these locations to a new, common platform that is centrally managed. Under our agreement with HP, server management and maintenance, technology field support, application support and development and help desk functions are managed by HP. In addition, HP managed the installation of and conversion to our new, common core banking system in Bermuda and the Cayman Islands which went live in 2011.

We have entered into additional contractual obligations in the normal course of business which are not significant to the amounts above.

RISK MANAGEMENT

Risk Governance

The Group's risk governance and management structure is illustrated below:



The Board of Directors oversees the Group's risk management programme through the approval of the Risk Appetite Framework and supporting risk management policies. It accomplishes its mandate through the activities of two dedicated committees:

The Risk Policy & Compliance Committee: This Committee assists the Board in fulfilling its responsibilities by overseeing the Group's risk profile and its performance against approved risk appetites and tolerance thresholds. Specifically, the Committee considers the sufficiency of the Group's policies, procedures and limits related to the identification, measurement, monitoring and control of activities that give rise to credit, market, liquidity, interest rate, operational and reputational risks, as well as overseeing its compliance with laws, regulations and codes of conduct.

The Audit Committee: This Committee reviews the overall adequacy and effectiveness of the Group's system of internal controls and the control environment, including those that are brought to bear in respect of the risk management process. It reviews recommendations arising from internal and independent audit review activities and Management's response to any findings raised.

Both the Risk Policy & Compliance Committee and the Audit Committee are supported in the execution of their respective mandates by the dedicated Audit, Compliance & Risk Policy Committees for our UK, Guernsey, Cayman and The Bahamas, which oversee the sufficiency of local risk management policies and procedures and the effectiveness of the system of internal controls that are in place. These Committees are chaired by Non-Executive Directors drawn from our jurisdictional Boards.

The Group Executive Management team, led by the Chairman & Chief Executive Officer ("Chairman") and including the members of Executive Management reporting directly to the Chairman, is responsible for setting business strategy and for monitoring, evaluating and managing risks across the Group. It is supported by the following committees:

The Group Risk Committee ("GRC"): This is the Senior Management Committee with responsibility for risk governance. It provides a forum for the strategic assessment of risks assumed across the Group as a whole, based on an integrated view of credit, market, liquidity, legal and regulatory compliance, operational, interest rate, investment, capital and reputational risks, ensuring that these exposures are consistent with the risk appetites and tolerances promulgated by the Board. It is responsible for reviewing, evaluating and recommending the Group's Risk Appetite Framework, the results of the capital assessment and risk profile ("CARP") process (including all associated stress testing performed) and the Group's key risk policies to the Board of Directors for approval, for reviewing and evaluating current and proposed business strategies in the context of our risk appetites and for identifying, reviewing and advising on current and emerging risk issues and associated mitigation plans.

Its membership is drawn from the Group Executive Management team, including the Chairman. The meeting is chaired by the Chief Risk Officer.

The Group Asset & Liability Committee: This Committee is responsible for liquidity, interest rate and exchange rate risk management and other Balance Sheet issues. It also oversees the execution of the Group's investment and capital management strategies and monitors the associated risks assumed. It is supported in the execution of its mandate by the work undertaken by the dedicated Asset & Liability Committees in each of the Bank's jurisdictional business units.

Its membership is drawn from the Group Executive and Senior Management teams, including the Chief Risk Officer and the Chairman. The meeting is chaired by the Chief Financial Officer.

The Group Credit Committee: This Committee is responsible for a broad range of activities relating to the monitoring, evaluation and management of credit risks assumed across the Group, at both transaction and portfolio levels. It is supported in the execution of its mandate by the Financial Institutions Committee, a dedicated sub-committee that is responsible for the evaluation and approval of recommended inter-bank and counterparty exposures assumed in the Group's treasury and investment portfolios, and by the activities of Credit Committees for our European and Cayman operations, which review and approve transactions within delegated authorities and recommend specific transactions outside of these limits to the Group Credit Committee for approval.

Its membership is drawn from the Group Executive and Senior Management teams. The meeting is chaired by the Chief Risk Officer.

The Provisions & Impairments Committee: This Committee is responsible for approving significant provisions and other impairment charges. It also oversees the overall credit risk profile of the Group in regard to non-accrual loans and assets. It is supported in the execution of its mandate by local Credit Committees and the Group Credit Committee, which make recommendations to this Committee.

Its membership is drawn from the Group Executive Management team, including the Chairman. The meeting is chaired by the Chief Risk Officer.

The Policy Development Committee: This Committee is responsible for overseeing the design, development and maintenance of the Group's framework of operational policies. It develops recommendations regarding policy requirements, engages with nominated members of Executive Management to ensure that policies are drafted or updated on a timely basis and provides a forum through which they are debated Group-wide prior to their adoption, thereby ensuring a consistency of application and interpretation. It also ensures that all policies and any policy exception requests are reviewed and recommended prior to presentation to the Group Risk Committee or Risk Policy & Compliance Committee of the Board for approval.

Its membership is drawn from the Senior Management team across the Group. It is chaired by the Group Head of Compliance.

Risk Management

The Group manages its exposure to risk through a three "lines of defence" model. This may be summarised as follows:

The first "line of defence": This is provided by our jurisdictional business units, which retain ultimate responsibility for the risks they assume and for bearing the cost of risk associated with these exposures.

The second "line of defence": This is provided by the Risk Management group, which works in collaboration with our business units to identify, assess, mitigate and monitor the risks associated with our business activities and strategies. It does this by:

- Making recommendations to the Group Risk Committee regarding the constitution of the Risk Appetite Framework.
- Setting risk strategies that are designed to manage risk exposures assumed in the course of pursuing our business strategies and aligning them with agreed appetites.
- Establishing and communicating policies, procedures and limits to control risks in alignment with these risk strategies.
- Measuring, monitoring and reporting on risk levels.
- Opining on specific transactions that fall outside delegated risk limits.
- Identifying and assessing emerging risks.

The four functions within the Risk Management group that support our risk management activities are outlined below. To ensure a formal separation of duties, each reports directly to the Chief Risk Officer.

Group Market Risk – This provides independent oversight of the measurement, monitoring and control of liquidity and funding risks, interest rate and foreign exchange risks as well as the market risks associated with the Group's investment portfolios. It also monitors compliance with both regulatory requirements and the Group's internal policies and procedures relating to the management of these risks.

Credit Risk Management – This unit is responsible for the adjudication and oversight of credit risks associated with our retail and commercial lending activities and the management of risks associated with our investment portfolios and counterparty exposures. It also establishes the parameters and delegated limits within which credit risks may be assumed and promulgates guidelines on how exposures should be managed and monitored.

Compliance – This unit provides independent analysis and assurance of the Group's compliance with applicable laws, regulations, codes of conduct and recommended best practices, including those associated with anti-money laundering/counter terrorist financing requirements. It is also responsible for assessing the Group's potential exposure to upstream risks and for providing guidance on the preparations that should be made in advance of these changes coming into effect.

Group Operational Risk – This unit assesses the effectiveness of the Group's procedures and internal controls in managing its exposure to various forms of operational risk, including those associated with new business activities and processes and the deployment of new technologies. It also oversees the Group's incident management processes and reviews the effectiveness of its loss data collection activities.

The third "line of defence": This is provided by our Group Internal Audit function, which provides ongoing review, oversight and challenge of the effectiveness of the internal controls that are executed by both the business and Risk Management communities in the management, monitoring and measurement of our exposure to risk. This includes the review of the accuracy of the underlying data and appropriateness of the stress testing methodologies that are executed as a part of our Capital Adequacy & Risk Profile processes.

The Risk Appetite Framework

The Risk Appetite Framework is the cornerstone of our approach to risk management. Developed by Executive Management and approved formally by the Board of Directors, it communicates a willingness to take on certain risks in the pursuit of our strategic objectives and defines those that should be avoided. It also provides Management with a clear mandate regarding the amount and type of risk that it may accept and establishes minimum expectations regarding the practices and behaviours that should be brought to bear in managing the exposures assumed. It is aligned with the interests of our stakeholders, feeds into our business planning processes, and shapes our discussions on risk matters generally.

Our framework comprises the following elements:

(i). Nine broad categories of risk: Credit; Market; Liquidity; Legal & Regulatory; Governance; Process & Technology; People; Country & Political; and Reputational. These represent the various risks that the Group assumes across the entirety of its operations in the pursuit of its strategic goals.

(ii). For each risk category, there is a declared risk appetite. To ensure consistency in our risk conversations, these have been distilled into the three options set out in the table below, with each appetite designed to convey a clear strategic direction in terms of the risk/reward profile assumed:

APPETITE	DEFINITION	PROFILE
Averse	The Group will work to avoid exposure to this risk given its potential for financial loss, reputational damage, and/or the loss of customer and / or investor confidence.	Our processes and controls are defensive and focus on detection and prevention.
Cautious	Given the potential for financial loss, reputational damage, and the loss of customer and/or investor confidence, the Group will be very selective in the exposures assumed to this risk and will monitor it closely.	Security is favoured over reward. Exposures are only assumed when the risk can be quantified accurately and is assessed as being acceptable.
Open	The Group will consider opportunities to accept this risk and will accept those that fall within clearly defined parameters. The risk of loss or reputational damage is accepted but the exposure can be estimated reliably and can be managed to a tolerable level.	Reward is commensurate with the risk assumed. Exposures can be estimated reliably and structures, systems and processes are in place to manage it.

(iii). A statement of our governing principles relating to each risk category. This establishes the characteristics of the risks that the Bank is willing to assume and the management behaviours that we should exhibit when doing so.

Specific performance measures and tolerance thresholds in respect of each risk category, combining quantitative and qualitative targets (which are designed to reflect both forward looking as well as historical perspectives), are designed to provide Executive Management and the Board with an indication of the "direction" of our exposure relative to our declared risk appetite and an early warning of material adverse developments requiring remedial action. The metrics are monitored independently by the Group Risk function and are measured against actual results. The results of these analyses are reported to Management at all levels of the organisation and are reviewed regularly by both the Group Risk and Risk Policy and Compliance Committees in the performance of their oversight activities.

Application Of The Risk Appetite Framework

The limits, targets and thresholds used to measure performance continue to be refined by the Group Risk Management function in an effort to express as complete a "picture" as possible of our exposure to a given risk, relative to the stated appetite. All changes proposed pass through a formal review and approval process at both the Executive Management and Board levels prior to their adoption.

Through this approach, the Risk Appetite Framework sets the tone for our risk culture across the Group as a whole, influencing behaviours at all levels of the organisation and reinforcing accountability for decisions taken. Many of our Jurisdictional offices have developed subsidiary risk appetite frameworks in conjunction with their local Risk Management functions. This ensures appropriate coverage of local risk factors and the establishment of proportional tolerance thresholds. Group Risk has reviewed these frameworks prior to their adoption and has modified any appetites proposed that are considered to be inconsistent with the overall Group approach.

Credit Ratings

Our credit ratings are provided in the table below:

	Standard & Poor's	Moody's	Fitch
Short-term deposits	A-2	P-1	F1
Long-term deposits and debt	A-	A2	A-
Outlook	Negative	Negative	Stable

scope
hand
touch

In particular

motion
sight
addition

Bermuda

For more than 150 years, Bermuda has served as Butterfield's headquarters and remains the Bank's largest jurisdiction in terms of number of employees, Banking Centre locations and business volume. Butterfield is Bermuda's largest independent bank, offering a full range of community banking services and wealth management, including private banking, asset management and personal trust services. Butterfield also provides services to corporate and institutional clients in Bermuda, which include asset management and corporate trust services.

Net income before gains and losses was $25.1 million in 2012, up $3.4 million from $21.7 million in 2011. Including net gains and losses—mainly one-time items in respect of fixed asset impairments and write downs and the sale of an affiliate—net income of $12.1 million for 2012 represented a decrease of $14.3 million year over year.

Net interest income fell $2.4 million to $130.1 million in 2012 due to reduced loan volumes and depressed investment yields owing to the historically low interest rates. The net interest margin held steady at 3.2%, due primarily to lower deposit costs that offset the lower yields earned on loans and investments.

Provisions for credit losses were $6.4 million in 2012, compared to $1.2 million in 2011; the increase is mainly attributable to the Bank's residential mortgage portfolio. An allowance for credit losses of $37.7 million represents a coverage ratio of 38.9% against non-performing loans of $96.7 million, which were up $8.0 million from $88.7 million in 2011. The increase was due to an $11.1 million rise in non-performing residential mortgages, totalling $45.9 million as at year end, offset by a decrease of $2.7 million in commercial non-performing loans to $47.8 million. Non-performing consumer loans improved by $0.4 million to end the year at $3.0 million.

Non-interest income of $65.6 million in 2012 was down 2.3% from 2011, reflecting lower foreign exchange, custody, and trust revenues, which were partially offset by increases in asset management fees and higher than normal loan prepayment fees.

Total expenses were down $12.5 million to $164.2 million in 2012, compared to $176.7 million in 2011. Salary costs declined $5.4 million as a result of reduced headcount which ended the year at 615, down 49, partially due to the Bank's voluntary early retirement programme, combined with natural attrition and redundancies. Expense savings, principally from expense management initiatives, contributed an additional $9.5 million in cost reductions, offset by a $2.4 million increase in technology costs from higher depreciation on system upgrades.

Total assets as at 31 December 2012 were $4.7 billion, up $0.2 billion from 2011. Customer deposits ended the year at $3.4 billion, up $0.1 billion from 2011, and loan balances decreased $0.2 billion to $2.2 billion compared to the prior year, mainly from the repayment of a Bermuda Government loan.

Client assets under administration for the trust and custody businesses were $30.1 billion and $27.8 billion, respectively, whilst assets under management declined by $0.3 billion to $3.1 billion.

(in $ thousands)	2012	2011	$ change	% change
Net interest income	130,133	132,552	(2,419)	(1.8%)
Provision for credit losses	(6,372)	(1,202)	(5,170)	(430.1%)
Non-interest income	65,559	67,080	(1,521)	(2.3%)
Revenue before gains and losses	189,320	198,430	(9,110)	(4.6%)
Total expenses	(164,232)	(176,725)	12,493	7.1%
Net income before gains and losses	25,088	21,705	3,383	15.6%
Net gains (losses)	(12,974)	4,753	(17,727)	(373.0%)
Net income	**12,114**	**26,458**	**(14,344)**	**(54.2%)**
As at 31 December				
(in $ millions)				
Customer deposits	3,364	3,260	104	3.2%
Loans, net of allowance for credit losses	2,208	2,456	(248)	(10.1%)
Total assets	**4,733**	**4,575**	**158**	**3.5%**
Assets under administration				
Custody and other administration services	27,819	28,156	(337)	(1.2%)
Trust	30,062	29,635	427	1.4%
Assets under management				
Butterfield Funds	2,335	2,653	(318)	(12.0%)
Other assets under management	747	752	(5)	(0.7%)
Total assets under management	**3,082**	**3,405**	**(323)**	**(9.5%)**
Number of employees	**615**	**664**	**(49)**	**(7.4%)**

Cayman Islands

Butterfield is a leading financial services provider in the Cayman Islands, offering a comprehensive range of personal and corporate financial services. In addition to our strong retail presence, Butterfield is also focused on our wealth management offering through an award winning private banking service as well as asset management and trust services.

2012 saw the opening of Butterfield's new retail branch at Midtown Plaza. In keeping with our commitment to service excellence, the new Banking Centre offers contemporary, spacious surroundings in an excellent location. With three Banking Centres and 12 ATMs strategically located around Grand Cayman, Butterfield continues to be a leader in the provision of financial services.

Net income before gains and losses of $19.5 million was more than double the prior year's $9.0 million. The increase primarily reflects a $7.3 million increase in net interest income and a reduction of $2.7 million in provisions for credit losses. Net income increased by $13.0 million to $24.0 million in 2012.

Net interest income before loan loss provisions was $44.6 million in 2012, $7.3 million ahead of the prior year, driven primarily by the increase in investment income resulting from an average increase of $152 million in fixed income investments, which contributed to improved net interest margin of 2.3%, up from 2.0% in 2011.

Provisions for credit losses decreased by $2.7 million from reductions and recovery in provisions in the Cayman loan portfolio of $3.4 million in 2012 compared to 2011, offset by increased provisioning of $0.7 million on the Bahamian residential mortgage book in 2012.

Non-interest income of $30.9 million in 2012 was up $0.3 million compared to the prior year, reflecting improved banking fees and foreign exchange commissions.

Total expenses of $54.8 million were $0.2 million below prior-year levels from broad-based expense management partially offset by increased technology and communications costs arising from increased depreciation and the introduction of a virtual private network system.

Total assets at 31 December 2012 were $2.1 billion, up $0.1 billion from year-end 2011, reflecting higher corporate client deposit levels.

Net loans decreased by $16.5 million from year-end 2011, reflecting significant principal repayments primarily on residential mortgages.

Client assets under administration for the trust and custody businesses were $1.7 billion and $1.4 billion, respectively, whilst assets under management declined by $0.2 billion to $0.8 billion.

(in $ thousands)	2012	2011	$ change	% change
Net interest income	44,633	37,325	7,308	19.6%
Provision for credit losses	(1,291)	(3,974)	2,683	67.5%
Non-interest income	30,940	30,651	289	0.9%
Revenue before gains and losses	74,282	64,002	10,280	16.1%
Total expenses	(54,829)	(54,987)	158	0.3%
Net income before gains and losses	19,453	9,015	10,438	115.8%
Net gains (losses)	4,497	1,956	2,541	129.9%
Net income	**23,950**	**10,971**	**12,979**	**118.3%**
As at 31 December				
(in $ millions)				
Customer deposits	1,862	1,743	119	6.8%
Loans, net of allowance for credit losses	705	722	(17)	(2.4%)
Total assets	**2,117**	**1,974**	**143**	**7.2%**
Assets under administration				
Custody and other administration services	1,417	1,226	191	15.6%
Trust	1,710	2,188	(478)	(21.9%)
Assets under management				
Butterfield Funds	176	211	(35)	(16.6%)
Other assets under management	621	760	(139)	(18.3%)
Total assets under management	**797**	**971**	**(174)**	**(17.9%)**
Number of employees	**296**	**308**	**(12)**	**(3.9%)**

Guernsey

In Guernsey, Butterfield offers private banking, lending, asset management, custody, administered banking and fiduciary services.

Guernsey posted net income of $9.7 million in 2012, compared to net income of $9.4 million in 2011, an increase of $0.3 million or 3.6%.

Net interest income increased $3.2 million to $21.6 million in 2012, compared to $18.4 million in 2011. Average loan balances increased $92.1 million, contributing to a 0.32% increase in the net interest margin to 1.43% in 2012, up from 1.16% in the prior year.

Provisions for credit losses of $1.0 million were required in 2012, compared to $0.6 million last year.

Non-interest income decreased $1.7 million to $20.0 million, due to lower foreign exchange, asset management and custody revenue combined with lower income from administered banking services. This was offset by a 4.7% increase in revenues from trust services, up $0.3 million year on year.

Total expenses, at $30.8 million, were $0.6 million higher than 2011, due mainly to an increase in salary and employee benefit costs, up 8.9% to support increased regional centralisation, and an increase in technology expense, offset by savings in property, professional services and other expenses.

Total assets at 31 December 2012 of $1.5 billion were consistent with year-end 2011.

Client assets under administration for the trust, custody and administered banking businesses were $9.9 billion (2011: $8.2 billion), $7.4 billion (2011: $6.7 billion), and $1.5 billion (2011: $1.7 billion), respectively reflecting solid growth in the trust business line. Client assets under management were consistent with the prior year at $0.6 billion.

(in $ thousands)	2012	2011	$ change	% change
Net interest income	21,564	18,379	3,185	17.3%
Provision for credit losses	(980)	(636)	(344)	(54.1%)
Non-interest income	20,005	21,665	(1,660)	(7.7%)
Revenue before gains and losses	40,589	39,408	1,181	3.0%
Total expenses	(30,810)	(30,245)	(565)	(1.9%)
Net income before gains and losses	9,779	9,163	616	6.7%
Net gains (losses)	(31)	242	(273)	(112.8%)
Net income	**9,748**	**9,405**	**343**	**3.6%**
As at 31 December				
(in $ millions)				
Customer deposits	1,370	1,334	36	2.7%
Loans, net of allowance for credit losses	533	453	80	17. 7%
Total assets	**1,522**	**1,480**	**42**	**2.8%**
Assets under administration				
Custody and other administration services	8,958	8,416	542	6.4%
Trust	9,905	8,242	1,663	20.2%
Assets under management				
Butterfield Funds	246	141	105	74.5%
Other assets under management	343	447	(104)	(23.3%)
Total assets under management	**589**	**588**	**1**	**-**
Number of employees	**173**	**165**	**8**	**4.9%**

United Kingdom

In the UK, Butterfield provides a range of exclusive banking, lending, treasury and investment management services. This includes family office services to high net worth international clients and their advisers from offices in London.

During 2011, Butterfield re-focused its business on providing exclusive private banking and wealth management services to wealthy clients and their families through the exit of non-core business. As part of the re-focused private banking strategy, the Bank enhanced its credit offering through the recruitment of a specialist team of experienced relationship managers to meet the demand of its clients. The Bank's lending focus is on providing lending services to wealthy clients at modest loan-to-value ratios secured on Prime Central London residential property.

The United Kingdom recorded a net loss of $24.6 million in 2012, compared to a loss of $3.3 million in 2011. The majority of the loss was a result of one-off impairments of the UK's goodwill and intangible assets totalling $16.6 million and a deferred tax valuation allowance and tax adjustment of $5 million.

Net interest income before credit provisions of $14.2 million was up $1.5 million. The net interest margin climbed 0.20% to 1.52% in 2012 from growth of $62 million in average loan balances and the repayment of subordinated debt in early 2012, offset by lower yields achieved on the investment portfolio.

Provisions for credit losses of $5.5 million were required in 2012, compared to $6.7 million of credit losses last year; both years' provisions related to legacy commercial loan facilities.

Non-interest income was $8.2 million, down $2.8 million from the prior year as a result of the cancellation of an investment management agreement with Bentley Reid at the end of the second quarter, and lower customer-led foreign exchange volumes.

Total expenses, at $24.6 million, were $4.3 million higher than 2011 due to the previously noted $5 million income tax expense offset by continued cost management initiatives and the reduction in the UK headcount year on year.

Total assets stood at $0.9 billion at 31 December 2012, down from $1.0 billion at 31 December 2011. Loan balances increased $73 million from $433.6 million, offset by a reduction in investment and cash balances. Customer deposit balances declined by $25.7 million to end the year at $709.3 million.

Assets under management, totalling $0.2 billion, decreased from $0.6 billion at year-end 2011 following the termination of the Bentley Reid investment services contract. Custody client assets under administration at the end of 2012 amounted to $1.7 billion, up $0.4 billion from $1.3 billion at year-end 2011.

(in $ thousands)	2012	2011	$ change	% change
Net interest income	14,197	12,687	1,510	11.9%
Provision for credit losses	(5,547)	(6,724)	1,177	17.5%
Non-interest income	8,177	10,928	(2,751)	(25.2%)
Revenue before gains and losses	16,827	16,891	(64)	(0.4%)
Total expenses	(24,565)	(20,253)	(4,312)	(21.3%)
Net income before gains and losses	(7,738)	(3,362)	(4,376)	(130.2%)
Net gains (losses)	(16,895)	45	(16,940)	N/A
Net income	**(24,633)**	**(3,317)**	**(21,316)**	**(642.6%)**
As at 31 December				
(in $ millions)				
Customer deposits	709	735	(26)	(3.5%)
Loans, net of allowance for credit losses	507	434	73	16.8%
Total assets	**925**	**976**	**(51)**	**(5.2%)**
Assets under administration – Custody	**1,662**	**1,276**	**386**	**30.3%**
Assets under management				
Butterfield Funds	77	330	(253)	(76.7 %)
Other assets under management	160	309	(149)	(48.2%)
Total assets under management	**237**	**639**	**(402)**	**(62.9%)**
Number of employees	**89**	**101**	**(12)**	**(11.9%)**

Group Asset Management

Butterfield Asset Management focuses on fulfilling the financial needs of those who demand the highest level of service and expertise. Each client has direct access to his or her portfolio manager who is, in turn, supported by a Group investment discipline designed to leverage resources from across the organisation, including a Core Strategy and Research team based in the United Kingdom.

The Group provides a broad range of investment services to institutional and private clients in Bermuda, the Cayman Islands, Guernsey, and the United Kingdom. Principal services include discretionary investment management and managed portfolio services. Advisory and self-directed brokerage options are available to clients in Bermuda and the Cayman Islands. The Group also provides money market and mutual fund offerings in all four jurisdictions. Institutional clients primarily consist of captive insurance companies in Bermuda and the Cayman Islands. Private clients are high net worth individuals and their fiduciary vehicles served in all four jurisdictions. Retail and mass affluent clients are served in Bermuda and the Cayman Islands as part of Butterfield's community banking platform.

Group Asset Management revenue was $22.3 million in 2012, compared to $22.9 million in 2011. The decrease of $0.6 million was principally due to the termination of the investment management agreement with Bentley Reid in the United Kingdom, offset slightly by increased fees earned on the Butterfield Money Market Fund as a result of higher LIBOR rates in 2012.

Assets under management decreased by $0.9 billion and 19% to end at $4.7 billion for 2012 due to the terminated agreement noted above and due to a decline in Money Market balances as clients sought better-yielding alternatives for short-term investments. Other trends continued through 2012 where insurance captives moved their assets back onshore, away from the Cayman Islands, and private clients were reluctant to invest in unstable markets.

Total assets under management ("AUM") at 31 December:

	2012			2011		
(in $ millions)	Butterfield Funds	Other assets	Total AUM	Butterfield Funds	Other assets	Total AUM
Bermuda	2,335	747	3,082	2,653	752	3,405
Cayman Islands	176	621	797	211	760	971
Guernsey	246	343	589	141	447	588
The Bahamas	35	-	35	40	1	41
UK	77	160	237	330	309	639
Total	**2,869**	**1,871**	**4,740**	**3,375**	**2,269**	**5,644**

Group Trust

Our trust and corporate services specialists deliver fiduciary solutions to meet a range of client needs, including estate and succession planning, administration of complex asset holdings, and efficient co-ordination for the affairs of international families; as well as the pension, employee benefit and other fiduciary requirements of multi-national corporations and institutions.

Alongside our traditional strengths in providing services to families and institutions with links to the United Kingdom, North America, and Europe, in 2012 we continued to progress in building relationships with clients connected to the Asian and Latin American regions.

Our goal is to deliver consistently reliable service to our clients underpinned by the technical expertise and competencies of our multi-jurisdictional team, which operates through separately incorporated trust businesses in our jurisdictions of choice. To this end, training and continual professional development for our staff remained a key priority in 2012. Active participation by our personnel in their local branches of leading trust industry associations and bodies such as the Society of Trust and Estate Practitioners also assists our employees in remaining at the forefront of their specialisation.

We provide both personal and institutional trust services from our operations in Bermuda, The Bahamas, the Cayman Islands, Guernsey and Switzerland, with our multi-jurisdictional capability therefore spanning the world's leading international trust and fiduciary centres. Trust revenues are derived from a combination of fixed fees, fees based on the market values of assets held in trust and fees based on time spent in relation to the range of personal trust and company administration services, and the pension, employee benefit and other corporate trust services we provide.

In 2012, trust revenues totalled $29.1 million, marginally lower than the $29.5 million recorded in 2011 due mainly to substantial one-time fees in 2011 which did not recur in 2012, and also to the loss of one managed trust company mandate during 2011 offset by an increase in recurring income through structured, proactive business development activities, with good new business growth in our Switzerland, Guernsey and Bermuda trust businesses and increasing pipelines in our Bahamas and Cayman businesses. Trust revenues represented 23% of total non-interest income in 2012, up from 22% in 2011.

Total Trust assets under administration ("Trust AUA") at 31 December:

(in $ millions)	2012	2011
Bermuda	30,062	29,635
Cayman Islands	1,710	2,188
Guernsey	9,905	8,242
Switzerland	2,142	386
The Bahamas	3,250	3,439
UK	-	-
Total	**47,069**	**43,890**

numbers
order
depth

In focus

balance
detail
particular

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 judgment of Management.

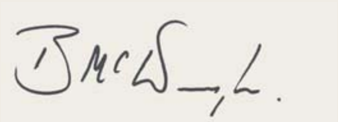
Management has established and maintains a system of financial reporting and internal controls to provide reasonable assurance that transactions are properly authorised and recorded, assets are protected against unauthorised use or disposition and liabilities are recognised. These procedures include 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 reports to, and has full and free access to the Audit Committee of the Board of Directors.

The Audit 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 Operations 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 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.



Brendan McDonagh
Chairman & Chief Executive Officer
26 February 2013

Bradley Rowse
Executive Vice President & Chief Financial Officer
26 February 2013

pwc

February 26, 2013

Independent Auditor's Report

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

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

Management's responsibility for the consolidated financial statements

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

Auditor's responsibility

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

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

PricewaterhouseCoopers, Chartered Accountants, P.O. Box HM 1171, Hamilton HM EX, Bermuda
T: +1 (441) 295 2000, F: +1 (441) 295 1242, www.pwc.com/bermuda

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

Opinion

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

PricewaterhouseCoopers

Chartered Accountants

Consolidated Balance Sheet

As at 31 December (in thousands of Bermuda dollars)

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

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

Brendan McDonagh
Chairman & Chief Executive Officer

Consolidated Statements of Operations

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

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

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

Consolidated Statements of Comprehensive Income (Loss)

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

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

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

Consolidated Statements of Changes in Shareholders' Equity

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

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

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

Consolidated Statements of Cash Flows

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

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

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

Notes to the Consolidated Financial Statements

(in thousands of Bermuda dollars)

NOTE 1: NATURE OF BUSINESS

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

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

NOTE 2: SIGNIFICANT ACCOUNTING POLICIES

a. Basis of Presentation and Use of Estimates and Assumptions

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

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

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

b. Basis of Consolidation

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

c. Foreign Currency Translation

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

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

d. Assets Held in Trust or Custody

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

e. Cash and Cash Equivalents

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

f. Short-Term Investments

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

g. Investments

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

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

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

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

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

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

Recognition of other-than-temporary impairments

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

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

Management's fair valuations may include inputs and assumptions that are less observable or require greater estimation, thereby resulting in values which may be greater or lower than the actual value at which the investments may be ultimately sold or the ultimate cash flows that may be recovered.

If the assumptions on which Management based its fair valuations change, the Bank may experience additional OTTI or realised losses or gains, and the period-to-period changes in value could vary significantly.

h. Loans

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

Impaired loans

A loan is considered to be impaired when, based on current information and events, the Bank determines that it will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Impaired loans include all non-accruing loans and all loans modified in a troubled debt restructuring (''TDR'') even if full collectability is expected following the restructuring.

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

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

Non-accrual

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

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

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

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

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

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

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

Loans Modified in a Troubled Debt Restructuring

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

j. Business Combinations, Goodwill and Intangible Assets

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

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

k. Premises, Equipment and Computer Software

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

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

l. Other Real Estate Owned

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

m. Derivatives

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

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

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

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

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

n. Securities Sold Under Agreements to Repurchase

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

o. Collateral

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

p. Employee Future Benefits

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

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

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

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

q. Share-Based Compensation

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

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

r. Revenue Recognition

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

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

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

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

s. Fair Values

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

Level 1, 2 and 3 valuation inputs

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

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

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

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

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

Cash and cash equivalents

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

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

Short-term investments

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

u. Income Taxes

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

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

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

v. Consolidated Statement of Cash Flows

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

w. Earnings Per Share

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

x. Impairment or Disposal of Long-Lived Assets

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

y. Charitable Trust

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

z. New Accounting Pronouncements

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

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

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

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

NOTE 3: DISCONTINUED OPERATIONS

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

The Bank has determined that the requirements have been met to report the results of the subsidiary sold as discontinued operations effective from the second quarter in 2012. The Assets and Liabilities have been presented as discontinued operations on the face of the Consolidated Balance Sheet for all periods presented.

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

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

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

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

NOTE 4: CASH AND CASH EQUIVALENTS

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

NOTE 5: SHORT-TERM INVESTMENTS

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

NOTE 6: INVESTMENTS

Amortised cost, carrying amounts and estimated fair value

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

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

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

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

Available for sale

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

US government and federal agency investment securities with an amortised cost of $120.9 million and fair market value of $122.4 million were pledged to secure repurchase agreements at 31 December 2012.

Held to maturity

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

Unrealised loss positions

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

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

2011	Less than 12 months		12 months or more			
	Fair value	Gross unrealised losses	Fair value	Gross unrealised losses	Total fair value	Total gross unrealised losses
Available for sale						
Certificates of deposit	48,623	(765)	-	-	48,623	(765)
US government and federal agencies	144,364	(1,585)	72,600	(417)	216,964	(2,002)
Debt securities issued by non-US governments	7,749	(49)	-	-	7,749	(49)
Corporate debt securities guaranteed by non-US governments	30,179	(3)	47,267	(1,374)	77,446	(1,377)
Corporate debt securities	217,612	(2,859)	124,152	(847)	341,764	(3,706)
Asset-backed securities - Student loans	-	-	144,346	(5,413)	144,346	(5,413)
Pass-through note	-	-	26,992	(6,705)	26,992	(6,705)
Equity securities	70	(50)	-	-	70	(50)
Total available-for-sale securities with unrealised losses	448,597	(5,311)	415,357	(14,756)	863,954	(20,067)
Held to maturity						
US government and federal agencies	30,034	(429)	-	-	30,034	(429)
Total held-to-maturity securities with unrealised losses	30,034	(429)	-	-	30,034	(429)

The Bank does not believe that the investment securities that were in an unrealised loss position as of 31 December 2012, which was comprised of 38 securities, or 24% of the portfolio by market value, represent an other-than-temporary impairment. Total gross unrealised losses were only 0.9% of the market value of affected securities and were primarily attributable to changes in interest rates, relative to when the investment securities were purchased, and not due to the credit quality of the investment securities. The Bank does not intend to sell the investment securities that were in an unrealised loss position and it is not more likely than not that the Bank will be required to sell the investment securities before recovery of the amortised cost bases, which may be at maturity.

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

US government and federal agencies

As of 31 December 2012, gross unrealised losses on securities related to United States ("US") government and federal agencies were $1.1 million (2011: $2.0 million). Overall, Management believes that all the securities in this class do not have any credit losses, given the explicit and implicit guarantees provided by the US federal government.

Asset-backed securities – Student loans

As of 31 December 2012, gross unrealised losses on student loan asset-backed securities were $3.2 million (2011: $5.4 million). Asset–backed securities collateralised by student loans are primarily composed of securities collateralised by Federal Family Education Loan Program ("FFELP loans"). FFELP loans benefit from a federal government guarantee of at least 97% of defaulted principal and accrued interest, with additional credit support provided in the form of overcollateralisation, subordination and excess spread, which collectively total in excess of 100%. Accordingly, the vast majority of FFELP loan–backed securities are not exposed to traditional consumer credit risk.

Contractual maturities

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

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

2011	Remaining term to earlier of expected or contractual maturity						
	Within 3 months	3 to 12 months	1 to 5 years	5 to 10 years	Over 10 years	No specific maturity	Carrying amount
Trading							
Debt securities issued by non-US governments	-	811	2,026	2,106	1,028	-	5,971
Mutual funds	-	-	-	-	-	56,620	56,620
Total trading	-	811	2,026	2,106	1,028	56,620	62,591
Available for sale							
Certificates of deposit	105,318	174,301	76,874	-	-	-	356,493
US government and federal agencies	-	-	82,444	452,951	255,407	2	790,804
Debt securities issued by non-US governments	7,749	64,057	5,333	11,519	-	-	88,658
Corporate debt securities guaranteed by non-US governments	-	90,882	30,766	-	-	-	121,648
Corporate debt securities	27,514	106,639	257,990	13,106	-	-	405,249
Asset-backed securities - Student loans	-	-	58,183	74,999	11,164	-	144,346
Pass-through note	-	-	-	26,991	-	-	26,991
Equity securities	-	-	-	-	-	70	70
Total available for sale	140,581	435,879	511,590	579,566	266,571	72	1,934,259
Held to maturity							
US government and federal agencies	-	-	-	-	64,789	-	64,789
Total held to maturity	-	-	-	-	64,789	-	64,789
Total investments	140,581	436,690	513,616	581,672	332,388	56,692	2,061,639
Total by currency							
US dollars	-	181,875	448,777	579,566	331,360	55,407	1,596,985
Other	140,581	254,815	64,839	2,106	1,028	1,285	464,654
Total investments	140,581	436,690	513,616	581,672	332,388	56,692	2,061,639

Sale proceeds and realised gains (losses)

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

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

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

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

Gains and losses on investments

The following table presents gains and losses on investments:

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

NOTE 7: LOANS

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

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

The principal means of securing residential mortgages, personal, credit card and business loans are charges over assets and guarantees. Mortgage loans are generally repayable over periods of up to 30 years and personal, credit card, business and government loans are generally repayable over terms not exceeding five years. The effective yield on total loans as at 31 December 2012 was 4.72% (2011: 4.76%).

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

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

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

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

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

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

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

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

	2012			2011		
	Non-accrual loans	Accruing loans past due 90 days	Total non-performing loans	Non-accrual loans	Accruing loans past due 90 days	Total non-performing loans
Commercial loans						
Commercial and industrial	3,606	-	3,606	4,160	-	4,160
Commercial overdrafts	292	9	301	5,683	-	5,683
Total commercial loans	3,898	9	3,907	9,843	-	9,843
Commercial real estate loans	55,167	417	55,584	53,599	8	53,607
Consumer loans						
Automobile financing	581	57	638	983	-	983
Credit cards	-	600	600	-	844	844
Overdrafts	217	10	227	65	11	76
Other consumer	1,984	76	2,060	1,789	173	1,962
Total consumer loans	2,782	743	3,525	2,837	1,028	3,865
Residential mortgage loans	51,506	27,229	78,735	43,828	17,372	61,200
Total loans	113,353	28,398	141,751	110,107	18,408	128,515

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

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

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

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

Quality classification definitions

Pass:

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

Special mention:

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

Substandard:

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

Non-accrual:

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

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

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

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

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

A loan is considered to be impaired when, based on current information and events, the Bank determines that it will not be able to collect all amounts due according to the loan contract, including scheduled interest payments. Impaired loans include all non-accrual loans and all loans modified in a TDR even if full collectability is expected following the restructuring. For the year ended 31 December 2012, the amount of gross interest income would have been recorded had impaired loans been current was $7.7 million (2011: $6.9 million). The table below presents information about the Bank's impaired loans:

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

2011	Impaired loans with an allowance			Impaired loans without an allowance	Total impaired loans		
	Gross recorded investments	Specific allowance	Net loans	Gross recorded investments	Gross recorded investments	Specific allowance	Net loans
Commercial loans							
Commercial and industrial	2,164	(1,803)	361	4,844	7,008	(1,803)	5,205
Commercial overdrafts	669	(669)	-	6,056	6,725	(669)	6,056
Total commercial loans	2,833	(2,472)	361	10,900	13,733	(2,472)	11,261
Commercial real estate loans	41,364	(12,017)	29,347	21,937	63,301	(12,017)	51,284
Consumer loans							
Automobile financing	240	(75)	165	743	983	(75)	908
Overdrafts	-	-	-	65	65	-	65
Other consumer	143	(85)	58	1,646	1,789	(85)	1,704
Total consumer loans	383	(160)	223	2,454	2,837	(160)	2,677
Residential mortgage loans	25,483	(8,821)	16,662	25,727	51,210	(8,821)	42,389
Total impaired loans	70,063	(23,470)	46,593	61,018	131,081	(23,470)	107,611

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

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

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

2012	Number of contracts	Recorded investment	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Effect of modification on recorded investment: Changes in the timing of principal or interest payments	Effect of modification on recorded investment: Interest capitalisation
Commercial loans						
Commercial and industrial	3	2,083	2,290	2,326	-	36
Total commercial loans	3	2,083	2,290	2,326	-	36
Commercial real estate loans	7	22,854	24,402	24,463	-	61
Residential mortgage loans	15	10,977	9,185	9,926	-	740
Total loans	25	35,914 (1)	35,877	36,715	-	837

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

2011	Number of contracts	Recorded investment	Pre-modification outstanding recorded investment	Post-modification outstanding recorded investment	Effect of modification on recorded investment: Changes in the timing of principal or interest payments	Effect of modification on recorded investment: Interest capitalisation
Commercial loans						
Commercial and industrial	4	2,847	2,777	2,777	-	-
Commercial overdrafts	1	1,042	1,142	1,142	-	-
Total commercial loans	5	3,889	3,919	3,919	-	-
Commercial real estate loans	5	22,279	23,121	23,183	-	61
Residential mortgage loans	11	7,382	7,146	7,336	9	180
Total loans	21	33,550 (1)	34,186	34,438	9	241

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

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

NOTE 8: CREDIT RISK CONCENTRATIONS

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

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

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

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

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

NOTE 9: PREMISES, EQUIPMENT AND COMPUTER SOFTWARE

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

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

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

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

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

NOTE 10: GOODWILL AND OTHER INTANGIBLE ASSETS

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

Goodwill

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

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

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

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

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

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

NOTE 11: CUSTOMER DEPOSITS AND DEPOSITS FROM BANKS

a) By Maturity

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

b) By Type and Location

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

NOTE 12: EMPLOYEE FUTURE BENEFITS

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

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

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

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

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

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

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

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

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

For the year ended	2012		2011	
	Pension plans	Post-retirement medical benefit plan	Pension plans	Post-retirement medical benefit plan
Actuarial assumptions used to determine annual benefit expense				
Weighted average discount rate	4.65%	4.60%	5.30%	5.50%
Weighted average rate of compensation increases	3.95%(1)	N/A	3.75%	N/A
Weighted average expected long-term rate of return on plan assets	5.60%	N/A	6.35%	N/A
Weighted average annual medical cost increase rate	N/A	7.5% to 4.5% in 2027	N/A	7.5% to 4.5% in 2027

(1) For 2012 excludes the inactive Bermuda Defined Benefit pension plan.

	2012 Pension plans	2012 Post-retirement medical benefit plan	2011 Pension plans	2011 Post-retirement medical benefit plan
Actuarial assumptions used to determine benefit obligations at end of year				
Weighted average discount rate	4.20%	4.40%	4.65%	4.60%
Weighted average rate of compensation increases	1.80%	N/A	1.70%	N/A
Weighted average annual medical cost increase rate	N/A	7.5% to 4.5% in 2027	N/A	7.5% to 4.5% in 2027

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

To develop the expected long-term rate of return on the plan assets assumption for each plan, the Bank considered the historical returns and the future expectations for returns for each asset class, as well as the target asset allocations of the funds. The weighted average discount rate used to determine benefit obligations at the end of the year is derived from interest rates on high quality corporate bonds with maturities that match the expected benefit payments. The expected weighted average annual medical cost increase rate remained unchanged commencing at 7.5% and reducing to 4.5% by 2027.

Investments policies and strategies

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

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

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

Fair value measurements of pension plans' assets

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

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

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

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

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

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

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

NOTE 13: CREDIT-RELATED ARRANGEMENTS AND COMMITMENTS

Commitments

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

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

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

Credit-Related Arrangements

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

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

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

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

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

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

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

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

The Bank has a facility by one of its custodians, whereby the Bank may offer up to US$200 million of standby letters of credit to its customers on a fully secured basis. Under the standard terms of the facility, the custodian has the right to set-off against securities held of 110% of the utilised facility. At 31 December 2012, $137.0 million (2011: $137.1 million) of standby letters of credit were issued under this facility.

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

Guarantees

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

Legal Proceedings

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

NOTE 14: INTEREST INCOME

Loans

The following table presents the components of loan interest income:

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

NOTE 15: SEGMENTED INFORMATION

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

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

The Cayman segment provides a comprehensive range of community and commercial banking services to private and corporate customers through three locations and through Internet banking, ATMs and debit cards. Wealth management and fiduciary services are also provided.

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

The Switzerland segment provides fiduciary services.

The Bahamas segment provides institutional, corporate and private clients with a range of wealth management & fiduciary services.

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

The Barbados segment was sold on 27 August 2012 as disclosed in Note 3: Discontinued operations.

Total Assets by Segment

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

For the year ended 2012 Net interest income

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

For the year ended 2011 Net interest income

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

NOTE 16: ACCOUNTING FOR DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT

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

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

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

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

Notional amounts

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

Fair value

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

Risk management derivatives

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

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

Risk management derivatives comprise:

Fair value hedges

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

Derivatives not formally designated as hedges

Derivatives not formally designated as hedges are entered into to manage the interest rate risk of fixed rate deposits with banks and foreign exchange risk of the Bank's non-USD investments in subsidiaries. Changes in the fair value of derivative instruments not formally designated as hedges are recognised in income.

Client service derivatives

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

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

2012	Derivative Instrument	Notional amounts	Positive fair value	Negative fair value	Net fair value
Risk management derivatives					
Fair-value hedges					
Fixed-rate loans	Interest rate swaps	8,529	-	(89)	(89)
Subtotal fair-value hedges		8,529	-	(89)	(89)
Derivatives not formally designated as hedging instruments					
	Currency swaps	343,684	113	(10,895)	(10,782)
Subtotal not designated as hedges		343,684	113	(10,895)	(10,782)
Subtotal risk management derivatives		352,213	113	(10,984)	(10,871)
Client services derivatives					
	Spot and forward foreign exchange	2,444,357	14,312	(13,972)	340
Subtotal client services derivatives		2,444,357	14,312	(13,972)	340
Total derivative instruments		2,796,570	14,425	(24,956)	(10,531)

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

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

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

NOTE 17: FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table presents the financial assets and liabilities that are measured at fair value on a recurring basis and classifies such fair value based on the type of input used in the related valuations, as described in Note 2.

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

Management classifies items that are recognised at fair value on a recurring basis based on the level of inputs used in their respective fair value determination, as described in Note 2.

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

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

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

Items that are recognised at fair value on a recurring basis

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

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

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

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

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

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

Unadjusted third party priced

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

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

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

Net Asset value of fund

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

Level 3 reconciliation

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

Items that are recognised at fair value on a non-recurring basis

	2012 Fair value				2011 Fair Value			
	Level 1	Level 2	Level 3	Total carrying amount / Fair value	Level 1	Level 2	Level 3	Total carrying amount / Fair value
Other real estate owned	-	34,360	-	34,360	-	27,354	-	27,354

Consistent with the significant accounting policy in Note 2, the current carrying value of Other real estate owned will be adjusted to fair value only when there is devaluation below cost.

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

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

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

NOTE 18: INTEREST RATE RISK

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

2012	Earlier of maturity or repricing date						
(in $ millions)	Within 3 months	3 to 6 months	6 to 12 months	1 to 5 years	After 5 years	Non-interest bearing funds	Total
Assets							
Cash and cash equivalents	1,435	-	-	-	-	217	1,652
Short-term investments	64	8	4	-	-	-	76
Investments	673	314	43	559	1,236	57	2,882
Loans	3,490	180	41	100	94	51	3,956
Premises, equipment and computer software	-	-	-	-	-	243	243
Other assets	-	-	-	-	-	133	133
Total assets	5,662	502	88	659	1,330	701	8,942
Liabilities and Shareholders' equity							
Shareholders' equity	-	-	-	-	-	857	857
Demand deposits	4,614	-	-	-	-	919	5,533
Term deposits	1,576	204	108	81	-	-	1,969
Securities sold under agreement to repurchase	109	-	-	-	-	-	109
Other liabilities	-	-	-	-	-	214	214
Subordinated capital	90	100	-	45	25	-	260
Total liabilities and Shareholders' equity	6,389	304	108	126	25	1,990	8,942
Interest rate swaps	8	-	(8)	-	-	-	-
Interest rate sensitivity gap	(719)	198	(28)	533	1,305	(1,289)	-
Cumulative interest rate sensitivity gap	(719)	(521)	(549)	(16)	1,289	-	-

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

NOTE 19: SUBORDINATED CAPITAL

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

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

On 27 June 2005, the Bank issued US $150 million of Subordinated Lower Tier II capital notes. The notes were issued at par in two tranches, namely US $90 million in Series A notes due 2015 and US $60 million in Series B notes due 2020. The issuance was by way of private placement with US institutional investors. The notes are listed on the BSX in the specialist debt securities category. The notes issued under Series A paid a fixed coupon of 4.81% until 2 July 2010 after which the coupon rate became floating and the principal became redeemable in whole at the Bank's option. At 31 December 2012, the Bank has not redeemed any of the notes issued under Series A and effective 2 July 2010 the coupon rate became floating at 3 months US$ LIBOR + 1.095%. The Series B notes pay a fixed coupon of 5.11% until 2 July 2015 when they also become redeemable in whole at the Bank's option. The Series A notes were priced at a spread of 1.00% over the 5-year US Treasury yield and the Series B notes were priced at a spread of 1.10% over the 10-year US Treasury yield. During September 2011, the Bank repurchased a portion of the outstanding 5.11% 2005 Series B Subordinated notes ("the Note"). The face value of the portion of the Note repurchased was $15 million and the purchase price paid for the repurchase was $13,875 million, which realised a gain of $1,125 million.

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

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

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

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

NOTE 20: EARNINGS PER SHARE

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

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

[1] Due to rounding, earnings per Share on continuing and discontinued operations may not sum to earnings per Share amount on net.

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

During 2012, weighted-average options to purchase 33.3 million (2011: 34.5 million) Shares of Common stock (see Note 21), were outstanding. Only options where the option's expense that will be recognised in the future and its exercise price was lower than the average market price of the Bank's Common stock were considered dilutive and, therefore, included in the computation of diluted earnings per Share. The dilution effect of such options is a net increase of 89,835 of the weighted-average number of Common Shares outstanding on a fully diluted basis. The awards' yet unrecognised expense is considered to be the proceeds the employees would need to pay to purchase accelerated vesting of the awards.

During 2012 the weighted-average number of outstanding awards of unvested Common Shares (see Note 21) was 7.2 million (2011: 3.8 million). All unvested awards of Common Shares were considered dilutive because each award's unrecognised expense was lower than the average market price of the Bank's Common stock. The awards' yet unrecognised expense is considered to be the proceeds the employees would need to pay to purchase accelerated vesting of the awards. For purpose of calculating dilution, such proceeds are assumed to be used by the Bank to buy back Shares at the average market price. The weighted-average number of outstanding awards net of the assumed weighted-average number of Shares bought back is included in the number of diluted participating Shares.

Warrants issued to the Government of Bermuda in exchange for the Government's guarantee of the Preference Shares, with an exercise price of $3.61 for 4.15 million Shares of Common stock were not included in the computation of earnings per Share in 2012 and 2011 because the exercise price was greater than the average market price of the Bank's Common stock.

NOTE 21: SHARE-BASED PAYMENTS

As at 31 December 2012, the Bank has three Share-based compensation plans, which are described below.

Stock Option Plans

1997 Stock Option Plan

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

2010 Stock Option Plan

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

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

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

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

The Bank determined the performance stock options granted have an aggregate fair value of $9.6 million. If the probability of a Valuation Event becomes more likely than not, some or all of the $9.6 million unrecognised expense relating to the performance vesting options will be recognised as an expense.

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

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

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

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

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

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

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

	2011					
	Number of Shares transferable upon exercise (thousands)			Weighted average exercise price ($)	Weighted average life remaining (years)	Aggregate intrinsic value ($ thousands)
	1997 Stock Option Plan	2010 Stock Option Plan	Total			
Outstanding at beginning of year	6,274	28,034	34,308	3.26		
Granted	-	1,260	1,260	1.24		
Exercised	-	-	-	-		
Forfeited / cancelled	(847)	(25)	(872)	11.10		
Resignations / Retirement / Redundancy	-	(906)	(906)	1.22		
End of plan expiration	(158)	-	(158)	5.84		
Outstanding at end of year	5,269	28,363	33,632	2.81	7.85	-
Vested and exercisable at end of year	5,269	162	5,431	12.41	4.95	

Employee Deferred Incentive Plan ("EDIP")
Under the Bank's EDIP Plan, Shares were awarded to Bank employees and Executive Management, based on time-vesting condition, which states that the Shares will vest equally over a three-year period from the effective grant date, subject to the employee's continued employment.

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

Executive Long-Term Incentive Share plan ("ELTIP")
Under the Bank's ELTIP, Shares were awarded to Bank employees and Executive Management, based on predetermined vesting conditions. Two types of vesting conditions upon which the Shares will be awarded comprise the ELTIP Plan, i.e.,:

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

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

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

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

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

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

The following table presents the unrecognised expense attributable to each plan:

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

Directors' Compensation

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

NOTE 22: SHARE BUY-BACK PLANS

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

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

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

The BSX must be advised monthly of Shares repurchased and cancelled by the Bank and Shares purchased by the Bank's Stock Option Trust.

NOTE 23: CAPITAL STRUCTURE

Authorised capital

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

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

Preference Shares

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

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

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

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

Regulatory capital

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

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

NOTE 24: DISPOSAL OF AFFILIATES

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

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

NOTE 25: VARIABLE INTEREST ENTITIES

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

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

NOTE 26: INCOME TAXES

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

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

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

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

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

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

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

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

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

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

Operating loss and tax credit carry forwards

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

NOTE 27: RELATED PARTY TRANSACTIONS

Employee loan programme

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

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

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

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

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

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

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

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

NOTE 28: COMPARATIVE INFORMATION
Certain prior-year figures have been reclassified to conform to current year presentation and restated for discontinued operations.

NOTE 29: SUBSEQUENT EVENTS
The Bank has performed an evaluation of subsequent events through to 26 February 2013. Subsequent to year end, the Board declared a special dividend of $0.04 per Common and Contingent Value Convertible Preference Share to be paid on 22 March 2013 to Shareholders of record on 5 March 2013.

numbers
addition
brief

In touch

essence
scope
balance

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 ownership of Common Shares and Contingent Value Convertible Preference Shares of the Bank by all Directors and Executive Officers* at 31 December 2012 was 2,617,914 Shares. In addition, this group owns 120 Non-Cumulative Perpetual Limited Voting Preference Shares. As of 31 December 2012, Executive Officers also owned 15,600,000 stock options pursuant to the 2010 Stock Option Plan to vest in accordance with timelines established by the Plan. None of the Directors or Executive Officers had any interest in any debt securities issued by the Bank or its subsidiaries as at 31 December 2012.

There are no service contracts with Directors, except for that of Brendan McDonagh, Chairman & Chief Executive Officer, whose contract expires on 5 April 2015.

Save for the foregoing contract, and those arrangements described in Note 27 to the Bank's 31 December 2012 Consolidated Financial Statements, there are no other contracts of significance subsisting during or at the end of the financial year ended 31 December 2012 in which a Director of the Bank is or was materially interested, either directly or indirectly.

**As listed on pages 6 and 7 of this Annual Report.*

EXCHANGE LISTING

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

BERMUDA STOCK EXCHANGE
(Primary Listing)
30 Victoria Street
Hamilton, HM 12
P.O. Box HM 1369
Hamilton HM FX
Bermuda
Tel: (441) 292 7212
Fax: (441) 292 7619
www.bsx.com

CAYMAN ISLANDS STOCK EXCHANGE
(Secondary Listing)
Elizabethan Square, 4th Floor
P.O. Box 2408
George Town, Grand Cayman KY1-1105
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) 292 9947
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 website.

REGISTRAR AND TRANSFER AGENT

Butterfield Fulcrum Group (Bermuda) Limited
26 Burnaby Street
Hamilton, HM 11
Bermuda
Tel: (441) 299 3882
Fax: (441) 295 6759
E-mail: bntbshareholders@bfgl.com

MEDIA RELATIONS / PUBLICATION REQUESTS

Vice President, Communications, Brand & Public Affairs
Tel: (441) 299 1624
E-mail: mark.johnson@butterfieldgroup.com

INVESTOR RELATIONS

Senior Vice President, Finance
Tel: (441) 298 4758
E-mail: john.maragliano@butterfieldgroup.com

WRITTEN NOTICE OF SHARE REPURCHASE PROGRAMME — BSX REGULATION 6.38

The Bank introduced a Share Buy-Back Programme on 1 May 2012. Under this Programme, the Board of Directors authorised the repurchase of up to six million Common Shares and 2,000 Preference Shares. On 10 December 2012, the Board approved an increase in the number of Common Shares available for buy-back to 10 million, and the number of Preference Shares to 8,000.

During 2012, the Bank bought back 7.3 million Common Shares to be held as Treasury Shares at a cost of $9 million, and 4,422 Preference Shares, which were subsequently cancelled, at a cost of $5.4 million.

From time to time, the Bank's associates, insiders and insider's 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.

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. No Shares were purchased by the Bank's Stock Option Trust in the 12 months to 31 December 2012.

The Bank will continue to advise the BSX monthly of Shares repurchased and cancelled by the Bank and Shares purchased by the Bank's Stock Option Trust.

LARGE SHAREHOLDERS

As at 31 December 2012, the following were registered holders of 5% or more of the issued Share capital:*

Carlyle Global Financial Services Partners LP, 19.34%
Canadian Imperial Bank of Commerce, 18.81%
Wellcome Trust Investments, 6.94%
Ithan Creek Master Investor (Cayman) LP, 6.77%
Rosebowl Western, 6.77%

**Includes Common and Contingent Value Convertible Preference Shares and excludes Treasury Shares held.*

PRINCIPAL OFFICES & SUBSIDIARIES

This list does not include all companies in the Group.

The Bank of N.T. Butterfield & Son Limited
Group Parent Company, Community Banking, Corporate Banking, Private Banking, Credit and Treasury Services

Head Office
65 Front Street
Hamilton, HM 12
Bermuda
Tel: (441) 295 1111
Fax: (441) 292 4365
SWIFT: BNTB BM HM
E-mail: info@butterfieldgroup.com

Mailing Address:
P.O. Box HM 195
Hamilton, HM AX
Bermuda

BERMUDA

Country Head: Michael Collins,
Senior Executive Vice President

Butterfield Asset Management Limited
Investment Management
Managing Director: Michael Neff
65 Front Street
Hamilton, HM 12
Bermuda
Tel: (441) 299 3817
Fax: (441) 292 9947
E-mail: info@butterfieldgroup.com

Butterfield Securities (Bermuda) Limited
Brokerage Services
65 Front Street
Hamilton, HM 12
Bermuda
Tel: (441) 299 3972
Fax: (441) 292 9947
E-mail: info@butterfieldgroup.com

Butterfield Trust (Bermuda) Limited
Grosvenor Trust Company Limited
Trust & Fiduciary Services
Managing Director: Martin Pollock
65 Front Street
Hamilton, HM 12
Bermuda
Tel: (441) 299 3980
Fax: (441) 292 1258
E-mail: info@butterfieldgroup.com

THE BAHAMAS

Butterfield Trust (Bahamas) Limited
Trust & Fiduciary Services
Managing Director: Julien Martel
3rd Floor, Montague Sterling Centre,
East Bay Street
P.O. Box N-3242
Nassau, N.P.
The Bahamas
Tel: (242) 393 8622
Fax: (242) 393 3772
E-mail: bahamas@butterfieldgroup.com

CAYMAN ISLANDS

Butterfield Bank (Cayman) Limited
Community Banking, Corporate Banking, Private Banking, Asset Management
Managing Director: Conor O'Dea
Butterfield House
68 Fort Street
P.O. Box 705
Grand Cayman KY1-1107
Cayman Islands
Tel: (345) 949 7055
Fax: (345) 949 7004
E-mail: cayman@butterfieldgroup.com

Butterfield Trust (Cayman) Limited
Trust & Fiduciary Services
Managing Director: Brian Balleine
Butterfield House
68 Fort Street
P.O. Box 705
Grand Cayman KY1-1107
Cayman Islands
Tel: (345) 949 7055
Fax: (345) 949 7004
E-mail: trust.cayman@butterfieldgroup.com

GUERNSEY

Butterfield Bank (Guernsey) Limited
Private Client and Institutional Banking, Credit, Investment Management, Custody and Custodian Trustee Services, Administered Banking
Managing Director: John Robinson
P.O. Box 25
Regency Court
Glategny Esplanade
St Peter Port
Guernsey GY1 3AP
Channel Islands
Tel: (44) 1481 711 521
Fax: (44) 1481 714 533
E-mail: guernsey@butterfieldgroup.com

Butterfield Trust (Guernsey) Limited
Trust & Fiduciary Services
Managing Director: Paul Hodgson
P.O. Box 25
Regency Court
Glategny Esplanade
St Peter Port
Guernsey GY1 3AP
Channel Islands
Tel: (44) 1481 711 521
Fax: (44) 1481 728 665
E-mail: guernsey@butterfieldgroup.com

SWITZERLAND

Butterfield Trust (Switzerland) Limited
Trust & Fiduciary Services
Managing Director: Jim Parker
Boulevard des Tranchées 16
1206 Geneva
Switzerland
Tel: (41) 22 839 0000
Fax: (41) 22 839 0099
E-mail: switzerland@butterfieldgroup.com

UNITED KINGDOM

Butterfield Bank (UK) Limited
Private Banking, Asset Management, Credit and Treasury Services
Managing Director: Raymond Sykes
99 Gresham Street
London, EC2V 7NG
United Kingdom
Tel: (44) 207 776 6700
Fax: (44) 207 776 6701
E-mail: uk@butterfieldgroup.com