



# 2001 performance

return on equity **22.7%**  
up from 16.4% last year.

earnings per share **\$3.45**  
up 55.4% from \$2.22 last year.

new location **London**  
In February 2001 we purchased Matheson Bank Limited of London, United Kingdom.

new service **Internet Banking**  
During the year we introduced the first Internet banking service in Bermuda and Cayman.

new legislation **60/40**  
In April 2001 we were granted relief from the requirement to maintain 60% Bermudian ownership.



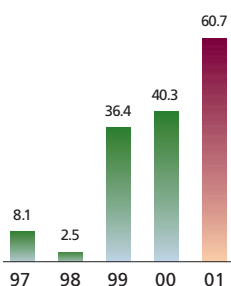
## Financial &amp; Statistical Summary

For the year ended 30 June 2001 (In \$ thousands except share data)	2001	2000
<b>For the Year</b>		
Net income from continuing operations	66,732	54,887
Loss from discontinued operations	(5,990)	(14,540)
Net income	60,742	40,347
Net income per share		
Including discontinued operations	\$ 3.45	\$ 2.22
Excluding discontinued operations	\$ 3.79	\$ 3.02
<b>At Year End</b>		
Total assets	5,197,804	4,794,012
Cash and deposits with banks	1,691,423	1,514,813
Investments	1,882,479	1,831,303
Loans	1,451,773	1,284,223
Deposits from customers	4,464,379	3,961,746
Deposits from banks	236,344	376,036
Subordinated debt capital	75,000	75,000
Shareholders' equity	286,525	250,197
Net book value per share	\$ 16.33	\$ 14.13
Market value per share	\$ 31.50	\$ 15.20
Number of shares (in thousands)*	17,571	17,705
Number of shareholders	3,619	3,602
Number of employees	1,162	1,113
<b>Financial Ratios</b>		
Return on assets (after discontinued operations)	1.23%	0.88%
Return on equity (after discontinued operations)	22.70%	16.40%
Total capital funds to total assets ratio	7.20%	6.96%
Risk weighted capital ratio	14.80%	13.20%

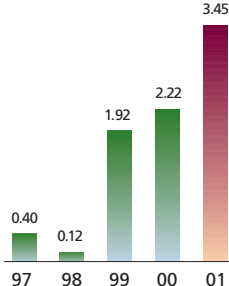
\* Excludes shares purchased by the Bank for the Stock Option Trust (See note 16 to the Consolidated Financial Statements.)

All percentages here and in the report that follows are based on actual rather than rounded numbers.

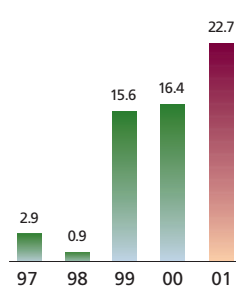
NET INCOME (\$m)



EARNINGS PER SHARE (\$)



RETURN ON EQUITY (%)



## Financial Year 2001 Performance

Net income for the year of \$60.7 million was a record for the Group and represents an increase of \$20.4 million, or 50.6%, over 2000.

Return on Equity was 22.7%, up from 16.4% in 2000.

Earnings Per Share was a record \$3.45, up \$1.23 or 55.4% on 2000.

Total income for the year from continuing operations was \$192.0 million, an increase of \$11.1 million, or 6.2%, over 2000. Net interest income increased by \$2.7 million, or 2.8%, to \$100.2 million and non-interest income increased by \$8.4 million, or 10.1%, to \$91.8 million.

Total expenses for the year were \$125.3 million, down \$0.7 million, or 0.6%, on the previous year. This principally reflects reduced personnel costs offset by consultancy costs relating to systems in Bermuda.

Non-accrual loans were reduced by \$9.3 million to \$9.5 million at 30 June 2001, and over the past three years these have been reduced by \$90.2 million.

The Group's efficiency ratio, before credit provisions, corporation tax in Guernsey and the United Kingdom and losses from discontinued operations, was 62.2%, compared to 67.1% last year.

Return on Assets before losses from discontinued operations improved to 1.4%, compared to 1.2% last year. After losses from discontinued operations ROA was 1.2%.

Total client assets under administration, including mutual funds, were \$39.2 billion, an increase of 14.9% over a year ago. Assets under investment management increased by 12.7% to \$5.7 billion at 30 June 2001; these figures include the Butterfield Funds, which grew by 26.7% to \$3.2 billion at year end.

As at 30 June 2001 the risk weighted Total Capital ratio was 14.8%, of which Tier 1 Capital was 11.0%.

The quarterly dividend was increased by 3 cents, to 26 cents per share in November 2000, and by a further 2 cents, to 28 cents, in February 2001. This was followed by a 2 cent increase, to 30 cents, in May 2001 and another increase of 2 cents to 32 cents per share in August 2001. The dividend for the full year was \$1.16 per share, an increase of 41 cents per share, or 54.7%, on the 75 cents per share paid the previous year.

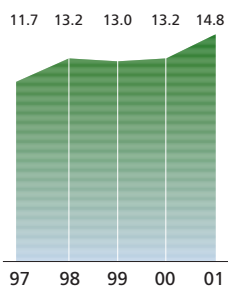
The Bank has engaged Standard & Poor's, the world renowned credit rating agency, to monitor and rate the Bank's own securities portfolios, which constitute some 90% of the Bank's total investments. All of these portfolios have received investment grade ratings, as highlighted in the table below.

## Investment Portfolios

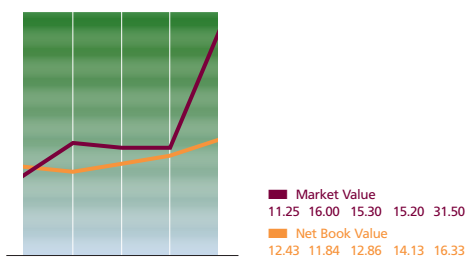
Summary of Group's debt securities monitored and rated by Standard & Poor's as at 30 June 2001.

PORTFOLIO	LOCATION	CARRYING VALUE	% OF TOTAL INVESTMENTS RATED BY S&P	S&P CREDIT RATING	S&P VOLATILITY RATING
Fixed Income	Bermuda	\$232.3m	13.7	AAf	S1
Floating Rate Notes	Bermuda	\$989.9m	58.2	Af	S1
Floating Rate Notes	Cayman	\$232.4m	13.7	Af	S1
Floating Rate Notes	Guernsey	\$137.1m	8.1	Af	S1
Higher Yield	Bermuda	\$107.9m	6.3	BBB-f	S3

RISK WEIGHTED CAPITAL RATIO (%)



MARKET VALUE AND NET BOOK VALUE PER SHARE (\$)





## Corporate Profile

*In Bermuda our Employee Solution Programme rewards employees' suggestions that result in improvements to processes, procedures and customer service.*



Our long, stable history originates with one of the families that settled Bermuda. The Butterfields farmed the island as early as the 1600s. In 1758, Nathaniel T. Butterfield founded a merchant-trading firm. In 1858, it became The Bank of N.T. Butterfield & Son, Bermuda's first bank.

We are proud to be the premier community bank on the island, with a fine reputation and a rich history that parallels Bermuda's development. By the late 1800s, we were supporting a budding tourism industry by lending money to innkeepers, retailers and companies building the island's infrastructure. In 1904, with the equivalent of about \$120,000 in assets, the Bank was incorporated by Act of Parliament. By 1923, we had 13 people on staff, and by 1946, we had 425 shareholders. By the 1950s, we were serving a burgeoning international business community.

Today, while still a vital community bank, we are also a well regarded specialist offshore financial services group. Bank of Butterfield Group provides institutional and individual customers with a range of banking, credit, treasury, investment, trust, custody and corporate services.

Our headquarters remain on Front Street in Bermuda's capital, Hamilton, and the island is home to our largest operation. We also have offices in the Cayman Islands, Guernsey, Hong Kong and the United Kingdom. We have over \$5 billion in assets and \$39 billion of client assets under administration.

Our success is built on fundamental strengths: a stable customer base, strong capital and liquidity positions and solid core businesses. The Bank also benefits from the efforts of a dedicated team of employees who work together to continue to build business, increase efficiency and improve service. In all, we had 1,162 employees at the close of financial year 2001, 744 in Bermuda and 418 overseas.

Our home country regulator is the Bermuda Monetary Authority, which operates in accordance with Basle principles and maintains close contacts with regulators in the other jurisdictions where we have offices. Bank of Butterfield common stock is listed on the Bermuda Stock Exchange and the Cayman Islands Stock Exchange. We have over 3,600 shareholders with 19 million shares outstanding.



A corporation grows strong when the community it serves is strong. At Bank of Butterfield, we are privileged to serve vibrant and successful communities. We understand our responsibility to make a real contribution to them.

Every year, Bank of Butterfield donates time and money to charities and community activities, in many cases as part of an ongoing commitment. Our corporate values dictate that we not only give to the communities we serve, we participate in them, and encourage our employees to become involved.

## fulfilling our commitment to our communities

The Bank targets our gifts for maximum community impact and ensures our sponsorships create community interest in areas such as education, sports, charities and the arts. In Bermuda, voluntary staff contributions matched dollar-for-dollar by the Bank, have funded BEST, Bank of Butterfield Employee Shared Trust, a partnership between the company and our employees. Through this progressive programme the monies will be invested into the community to further strengthen and enhance the lives of our citizens. Another of our activities is to fund scholarships so that young people in our community may pursue their dreams. We are confident that their success will be good for Bermuda and good for us, too. This year, we introduced a “Hot Jobs” Forum for university graduates, which provided first hand information about careers in Bermuda, at Bank of Butterfield and elsewhere.

Bank of Butterfield’s Grand Art Festival by the Sea has a well earned reputation in Bermuda as a great family outing, and our Concerts in the Park bring music of all types to delight audiences – all free of charge.

In Cayman, our sponsorship of a Children’s Art Residency programme with the Cayman National Cultural Foundation and our continuing support for Little League Baseball reflect our interest in youth development. Our five-year pledge to the Cayman Islands Cancer Society goes directly to patient care and equipment, and the annual St. Patrick’s Day Irish 5K Jog attracts hundreds of runners and spectators and raises funds for local charities.



## Chairman's Letter to the Shareholders



James A.C. King,  
MD, FRCS(C), FACS, JP  
*Chairman of the Board*

This report documents another year of considerable accomplishment and record profit for Bank of Butterfield. The achievements of the past year – both financial and strategic – are a solid indication of the Bank's success and limitless potential.

On the international front, Bermuda's reputation as a well regulated business centre was reinforced with positive reviews from both the Organisation for Economic Cooperation and Development (OECD) and the Financial Action Task Force on Money Laundering (FATF). Bermuda and the Cayman Islands were excluded from the OECD list of jurisdictions operating harmful tax practices. Bermuda, Cayman and Guernsey are not included on the FATF list of nations deemed to be uncooperative in the fight against money laundering.

Perhaps the most significant development of the year was obtaining a Section 114B licence for the Bank in Bermuda. This licence relieves the Parent Bank of the requirement to maintain 60% ownership by Bermudians. Although the Bank is very well capitalised, the 114B licence will enable us to raise capital in any market, should it be needed to facilitate acquisitions in Bermuda or elsewhere, or to support organic growth. Capital could be raised by private placement or by an additional listing of the Bank's shares, which are already listed on the Bermuda and Cayman Islands stock exchanges. Having said this, it is our firm intention to maintain the very strong influence that Bermuda and Bermudians have always exercised on the management and governance of the Group.

The year that ended 30 June 2001 saw the departure of Board member Lt. Col. M. L. Darling, who was appointed to the Board in September 1982 and has served on several important Board Committees. I would like to thank Col. Darling for his valuable service over the years. I again extend a warm welcome to Arlene Brock, our newest Board member, who was appointed in September 2000.

## a successful 2001

This year we began a process to identify a candidate to replace Calum Johnston, President & CEO, who has now served the Bank for almost four years. Since his appointment Mr. Johnston has demonstrated outstanding leadership, and his superb knowledge of banking and the finance industry in general have significantly contributed to the Bank's success. We have given ourselves ample time to find a qualified replacement and I am encouraged by the progress on the search thus far.

Looking back on another successful year, it is my pleasure to congratulate the management and employees of Bank of Butterfield for their combined efforts, which resulted in such strong performance.

We are also grateful to our shareholders and customers for their contribution to our success. We aim to continue to earn their loyalty and support by building on our strengths and focusing on our core business and strategic goals.

## President & Chief Executive Officer's Report

It is very pleasing to report, once again, a year of record profit. For the third consecutive year the Group recorded the highest level of net profit in its over 140 year history. All our financial targets were met or surpassed and return on shareholders' equity was a very satisfactory 22.7%, up from 16.4% last year. The expanded balance sheet remains highly liquid and the Group is well poised to achieve further profitable growth.

The financial year was one of substantial progress which saw several achievements with a single theme – building on our strengths in order to produce long term sustainable and profitable growth. With this in mind we were pleased to have the opportunity to re-establish the Group in a major financial market through the acquisition in London of Matheson Bank Limited, now renamed Bank of Butterfield (UK) Limited. This conservative bank provides the Group with an excellent opportunity to expand into the large and well regulated United Kingdom market. We are fortunate to have acquired a well established customer focused bank. Also, in a transaction that was developed during the year, but that closed just after the year end, we purchased the Guernsey business of CIBC, a major North American bank. As significant as the business and the customers acquired is the fact that we expect the excellent management team and staff to contribute substantially to our growing Guernsey business and to develop further the synergies that exist between Guernsey and London. We welcome the added management strength brought to the Group.



M. Calum Johnston, FICB  
*President & Chief Executive Officer*

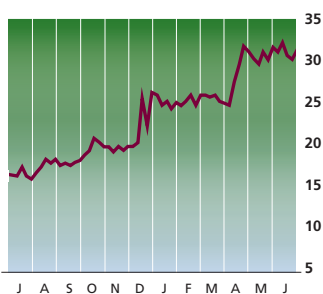
# this year's objectives were met or surpassed

In a major upgrade of our customer service we were pleased during the year to introduce the first and only Internet banking facilities in Bermuda and the Cayman Islands. This service has been welcomed enthusiastically by customers as has the opening of our technologically advanced new branch in Bermuda and our first drive through banking facility in Cayman. These developments and the establishment of our call centre in Bermuda are in full accord with our objective of being the pre-eminent financial institution in Bermuda and Cayman.

For the fourth consecutive year Butterfield Asset Management Limited won awards for our family of eight mutual funds, all of which are managed in-house. This year we won first place in the world for the five-year performance of our Butterfield Money Market Fund (GBP Class) and second place in the world for the one-year performance of our entire family of funds in their respective groups.



MARKET PRICE PER SHARE  
1 JULY 2000 - 30 JUNE 2001 (\$)



In previous years the book of discontinued loans has proved to be a drag on earnings and this year we have finally closed this chapter of our history by writing off all loans remaining from discontinued businesses. This, together with our continuing vigorous collection efforts, enabled us to reduce non-performing loans from \$18.8 million on 30 June 2000 to \$9.5 million on 30 June 2001. Shareholders will remember that on 30 June 1998 non-performing loans totalled \$99.7 million. The improvement in the quality of the loan book has contributed substantially to interest income, and thus to net profit, and we are determined to maintain the high quality now evident in the book.

During the year we again reviewed the segmentation of the loan portfolio and established detailed criteria for provisions for loan losses based on our experience and perception of the risk in each segment. On 30 June 2001, the General Provision for Loan Losses of \$20.6 million was equivalent to 1.4% of total loans. The General Provision is established in respect of any losses that have not been identified but that, in time, might become apparent. In addition to the General Provision, there is a Specific Provision of \$4.2 million for possible shortfalls in the security held for the \$9.5 million of loans identified as non-performing.

Our efforts to improve profitability and to strengthen the balance sheet were rewarded in November 2000 when Moody's Investor Service changed the Bank's outlook from stable to positive based on our improved earnings and asset quality performance, and stated that continued progress could have favourable rating implications. The Bank's improved performance was again acknowledged in June 2001 when Moody's raised the Bank's financial strength rating by two grades, to C. Banks rated C by Moody's possess good intrinsic financial strength with valuable and defensible business franchises. We believe this rating recognises the diversity and growing contributions to the Group of our operations in Cayman, Guernsey and Hong Kong, all of which produced record results for the year, and the potential in London. While your Bank does, indeed, have a valuable business franchise, our most important advantage is our people in all our locations. Their talent and commitment to our shared values of integrity and professional competence give us great confidence in our ability to deliver exceptional returns to our shareholders. Our people understand the challenges before us and the goals we have set in our efforts to increase shareholder value. This is not surprising because they too are shareholders. For the fourth consecutive year, on 2 July 2001 options in Bank shares were granted to all employees. With their help, in the coming year we intend to deliver an even higher level of performance for our shareholders, for whose support we are most grateful.

Our strategy is to build on our strengths, to take the things we do well to the next level.

For the Bank of Butterfield Group, those strengths are community banking and specialised offshore financial services, and we believe that, for us, those areas hold the greatest opportunities for business expansion and financial success.

We have identified elements of our operations as our core businesses, based on their continued profitability and potential for growth. Community Banking in Bermuda, where we are the premier domestic bank, is a key operation with historic importance and future potential. The same is true in Grand Cayman, where Bank of Butterfield is an important participant in a local economy that continues to expand. Our second core business is Asset Management. Over the years, we have developed expert skills, finely honed processes and robust systems to manage this complex international business. We can provide the highest quality service at a competitive price. Bermuda, Grand Cayman, London, Guernsey and Hong Kong offices offer these specialist offshore banking services to selected groups of clients. We are well established in each of these markets and co-ordinate our activities on a Group-wide basis.

In both these core businesses we are continuously seeking opportunities to increase profitability by widening our client base and deepening our relationships with existing clients by offering the right products at fair prices with personal service. It is what has made us strong and what will keep us that way.

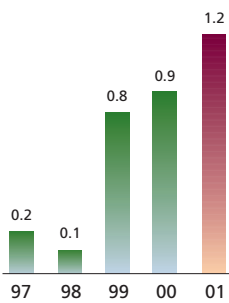


# Management's Analysis of Financial Condition & Review of Operations

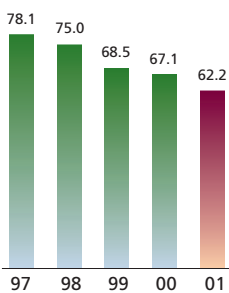


*Bank of Butterfield's Bermuda Call Centre, staffed by friendly, knowledgeable employees, was developed to handle calls from customers requesting information about the Bank, its services and products, and specific customer transactions.*

RETURN ON ASSETS (%)



EFFICIENCY RATIO (%)



## OVERVIEW OF PERFORMANCE

The Bank of N. T. Butterfield & Son Limited had record Group earnings of \$60.7 million after losses from discontinued operations of \$6.0 million for the year ended 30 June 2001. This represents an increase of \$20.4 million or 50.6% over the \$40.3 million achieved in fiscal 2000.

This is the third consecutive year of record earnings, reflecting and reinforcing the Group's strategy of concentrating on its core businesses and existing strengths. Throughout 2001, we have continued to apply our skills and knowledge to businesses and markets where we have both the strongest ability and the greatest opportunity. At the same time, we pursue efficiency in our operations. The result is that we actively and selectively market our services and move from strength to strength by doing what we do well; and we do more of it, more effectively, each year.

Our financial success grew through the activities of our core businesses. There was significant improvement in the profitability of our Community Banking business in Bermuda. Our Cayman Islands operation achieved record net income for the 13th consecutive year. Guernsey and Hong Kong operations continue to produce substantial business growth and contribute to our profitability. Our acquisition of Matheson Bank in the UK in February 2001, gives us a valued presence in a significant market.



Head Office, Bermuda



Above: Management in Bermuda: Graham C. Brooks, Executive Vice President – International & Trust; C. Wendell Emery, Executive Vice President – Operations; and Richard J. Ferrett, President and Chief Financial Officer.

This year Bank of Butterfield received exemption from the Bermuda Government’s “60/40 Rule,” legislation which requires Bermudian businesses to be 60% locally owned. Although our balance sheet is strong and highly liquid, relief from this requirement enhances the liquidity of our shares and increases their attractiveness to foreign shareholders.

In November 2000, Moody’s Investors Service, the international credit rating agency, improved our rating outlook from stable to positive, reflecting strong earnings growth achieved throughout our core businesses, both in Bermuda and overseas. In changing our rating outlook, Moody’s cited the Bank’s improved earnings and asset quality performance, and indicated that our continued efforts to improve the loan portfolio and strengthen profits, coupled with Bermuda’s strong economy, could have favourable implications for our ratings.

Then in June 2001, Moody’s announced that the Bank’s financial strength rating was raised two levels, from D+ to C. Banks rated C by Moody’s possess good intrinsic financial strength with valuable and defensible business franchises. The upgrade indicates continued recognition of our earnings growth, strong capital position and low-risk balance sheet.

### Performance Indicators

Certain key measures indicate the strong improvement in the Bank’s overall performance. Our efficiency ratio – operating expenses (excluding corporation tax) expressed as a percentage of operating income (excluding credit provisions) – is of particular interest to the Butterfield Group. For several years, improving this productivity indicator has been a key financial objective. Our judicious approach to revenue growth and expense management has proved effective. For the second year in a row, the efficiency ratio improved. At 62.2%, in 2001, this measure is down significantly from 67.1%, in 2000.

Our progress in improving our financial performance is due to the efforts of the 1,162 people we employ. Across the Group, average net contribution per employee in respect of continuing operations was \$59,000, up 22.9% from \$48,000 in 2000. Employees continue to discover and seize opportunities to increase business while seeking ways to reduce costs, build efficiency and improve service.

Growth in the loan portfolio reflects our ability to generate new demand for lending products, particularly in Community Banking in Bermuda and Cayman. As well as quantity, the quality of our loan book has improved. In 2001 non-accrual loans were reduced by 49.2% to \$9.5 million.

A review of the provisions required for the loan portfolio remaining from our former businesses in the United Kingdom resulted in the decision to write off these loans. This resulted in a loss of \$6.0 million from discontinued operations. No loans remain from these former businesses.

Modest recoveries in future years may occur from the loans written off.



Our quarterly customer newsletter, Bank Notes, began in January and provides information about our products and services, along with helpful financial advice.



Our newly designed web site www.bankofbutterfield.com displays valuable information about the Bank and our services in an easily navigated framework.

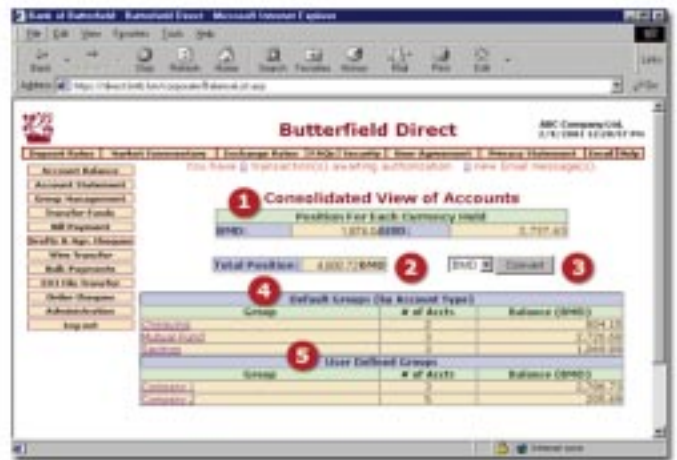
Butterfield Direct is the first Internet Banking product in Bermuda and the first tool that combines the Bank's systems so that customers can access all of their accounts at once.

### A Quick Tour (Page 2 of 6)

The Consolidated View of Accounts screen is the first screen you'll see when you log on to Butterfield Direct Internet Banking, and is also available any time by clicking "Account Balance" on the left hand menu.

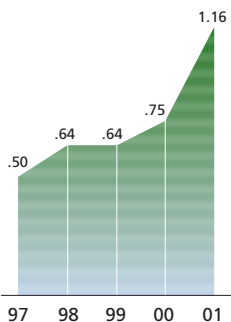
[Go to next Screen](#)

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ANNUAL DIVIDEND (\$)



The Group's return on equity (ROE) for the year was 22.7%, up from 16.4% in 2000. Earnings per share (EPS) from continuing operations were \$3.79, compared to \$3.02 the previous year. Return on assets (ROA) improved from 0.9% in 2000 to 1.2% in 2001. The Bank's Net Book Value per share increased by 15.6% to \$16.33.

During the year 420,637 shares were purchased and cancelled, at an average cost of \$20.42. The Board increased the dividend to shareholders four times during the course of the fiscal year to \$0.32 in the fourth quarter. The total dividend for the year was \$1.16 per share compared to \$0.75 per share in 2000, an increase of 54.7%. This represents a 33.8% payout on 2001 net income, in line with that for the last fiscal year. In addition, the Bank announced a one for ten bonus share issue to shareholders in August 2001.

### OUTLOOK

In our core markets – Bermuda and Cayman Islands – we expect that favourable conditions will be sustained. We are confident that the Bank will continue to find opportunities to maintain and grow its business in these and other jurisdictions.

Our presence in Guernsey, significantly strengthened by our acquisition of the Guernsey operations of the Canadian Imperial Bank of Commerce in July 2001, following that of ANZ Bank (Guernsey) Limited in January 2000, is positioned for continued success.

Despite uncertainty in the Asia-Pacific regional economies, our office in Hong Kong continues to improve profitability and is taking advantage of the many opportunities arising from Hong Kong's position as one of the key financial centres in the region and the introduction of a Mandatory Provident Fund.

The purchase of Matheson Bank – now Bank of Butterfield (UK) Limited – provides an entry into the United Kingdom market by way of a well established, customer focused bank that complements our existing businesses.

Our attention to improvement in key financial measures continues to show in our overall business results. We believe our careful attention to improving efficiency will further reduce our cost of doing business and, at the same time, raise the quality of our service.

## **BERMUDA**

Bermuda is home to the Bank's head office and our largest operation, which includes Community Banking and Asset Management. Set in the mid-Atlantic, due east of North Carolina, it is the United Kingdom's largest overseas territory with a population of 62,000. The 21-square-mile archipelago has a long-established tourism industry and is the base for a sophisticated international business community specialising in insurance and reinsurance. It is also an important domicile for mutual funds and offshore trusts, and is positioning itself as a preferred centre for global electronic commerce.

### **Community Banking**

Bank of Butterfield is one of only two banks providing a full range of retail, corporate and treasury services in Bermuda. These activities constitute an essential part of the Group's business, not only because Bermuda is the Bank's home base, but also because of the potential we see in the local Bermuda market.

### **Retail Banking**

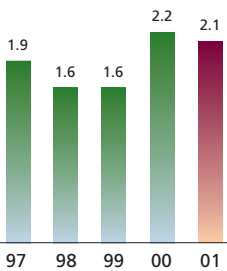
Through our retail operations in five locations, we provide a full range of deposit services, consumer and residential mortgage lending and personal insurance products in Bermuda. Services include a network of 31 Automated Teller Machines (ATMs), credit and debit cards, standing order payments, point of sale services, drafts, foreign currency exchange, wire payments and general branch services. Efficient and effective customer service is our priority and we are making the investment in staff training, information systems and improved processes to ensure service continually improves.



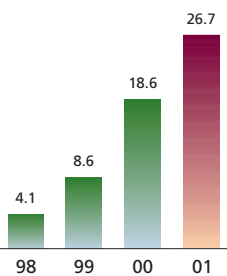
*The introduction of Butterfield Direct Internet Banking was the result of the hard work and commitment of a dedicated team. Butterfield Direct is Bermuda's first and, to date, only Internet banking solution.*



NET INTEREST MARGIN (%)



COMMUNITY BANKING, BERMUDA NET INCOME (\$m)



One of the most exciting developments for Retail Banking during 2001 was the launch of Butterfield Direct Internet Banking. Bank of Butterfield is the first and, to date, the only Bermuda bank to introduce Internet Banking to its customers. This convenient, secure service recognises that customers desire and require access to financial transactions at their convenience, not the Bank's. Using their computers at home or at work, they can now access chequing, savings, loan, money market, credit card and call accounts. They can view balances, pay bills and generate account statements and can even download reports into certain accounting software packages. Butterfield Direct is an important innovation that reinforces our commitment to meeting the needs of our customers.

Another major initiative this year was the opening, in August 2000, of our new 'Micro' Branch at the Waterfront complex on Pitt's Bay Road. This branch features three customer stations using a state-of-the-art, two-way audio/video communication system that allows tellers to serve customers from a remote location. Customer response has been enthusiastic and the branch team has attracted significant business in personal and small business accounts and services.

Also in August, Retail Banking introduced a new mortgage plan that makes it possible for more Bermudians to purchase homes. Affordable housing is an important concern for the people of Bermuda, and response to this programme has been very positive. Not only has it generated 67 mortgages worth \$21.2 million, for the public, it is further tangible evidence of our ongoing commitment to Bermuda and Bermudians.



*Left: Management in Bermuda: William G. Francis II, Senior Vice President – Information Systems; Michael A. McWatt, Senior Vice President – Credit Risk Management; and Peter J.M. Rodger, Senior Vice President, Group Legal Adviser, Secretary to the Board.*

In cooperation with the Government of Bermuda, the Bank introduced a scheme of interest free loans for the restoration of historic buildings. The Government pays the interest on the loans at a reduced rate provided by the Bank. The programme was introduced to encourage owners of the Island’s heritage buildings to maintain them in good repair and to help preserve Bermuda’s rich architectural history. This is of particular importance given the town of St. George’s recently affirmed status as a World Heritage Site.

Throughout the fiscal year, we have continued to review our Retail Banking operations, systems, premises and processes and make adjustments and improvements that provide more accurate and efficient service to customers.

### **Corporate Banking**

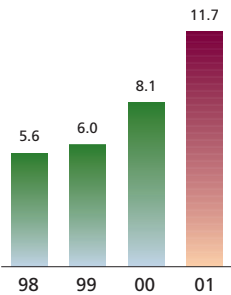
The Corporate Banking group provides a broad range of products and services, including commercial lending and mortgages, cash management, payroll services, remote banking and letters of credit.

This year, Corporate Banking showed continued strong growth in its Bermuda commercial loan portfolio. The Group continued its significant contribution to the redevelopment of the tourism industry, on which Bermuda relies so much. We provided loans to major cottage resort properties as well as important hotel/condominium projects. Other real estate funding enabled the construction of major office accommodation and affordable housing, through the Bermuda Housing Corporation.

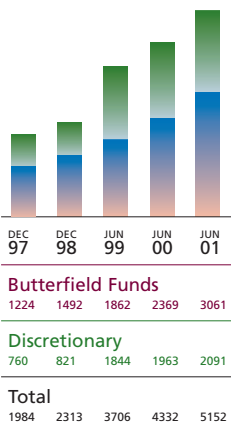




ASSET MANAGEMENT, BERMUDA  
NET INCOME (\$m)



ASSETS UNDER MANAGEMENT  
BY BUTTERFIELD ASSET  
MANAGEMENT (\$m)



For the fourth year running, Butterfield Funds have been recognised in the international investment arena with prestigious performance awards from Standard & Poor's Micropal.

Growth in our Letter of Credit business reflects our ongoing commitment to the insurance industry and we continue to be a key provider of cash management services to Bermuda's international business community, which has welcomed the introduction of Butterfield Direct.

### Treasury

The role of Treasury is that of the Bank's banker, managing the surplus funds within the Bank along with the interest rate and foreign exchange risks from client transactions. To manage the Bank's liquidity, Treasury has a two-way presence in the international money markets and ensures that we can meet our liabilities at all times.

During 2001, Treasury introduced a number of changes that benefit both the Bank and its customers and augmented our strong contribution to Community Banking's financial results.

We have reduced our brokerage costs by expanding our use of web based pricing systems for distributing foreign exchange (FX) risk. With the introduction of Butterfield Direct, our customers, too, can use the Internet to execute FX transactions up to \$100,000 or the equivalent in other currencies.



*Left: Management in Bermuda: Patricia G. Bean, Senior Vice President – Human Resources; Fred H. Tesch, Senior Vice President & Head of Group Internal Audit; and Peter G. Wignall, Senior Vice President – Asset Management and Managing Director, Butterfield Asset Management Limited.*

This year, we implemented a new model for Value At Risk (VAR) evaluation, an important measure of the sensitivity of the Bank's assets and liabilities to interest rate moves.

We have also introduced a Treasury Training Programme to attract Bermudian university graduates to careers in this field.

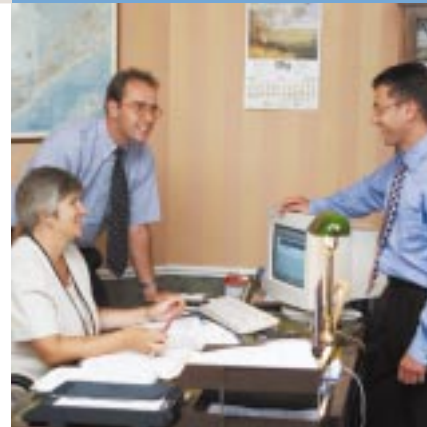
**Asset Management and Administration**

Three subsidiary companies comprise our Asset Management business in Bermuda: Butterfield Asset Management Limited, Butterfield Corporate Services Limited and Butterfield Trust (Bermuda) Limited. International in scope, these companies serve institutional and individual clients, including high net worth individuals and their families.

These companies are fee and commission earning, and are not capital intensive. Combined net income for 2001 was \$11.7 million, up 44.6% from the previous year.

**Butterfield Asset Management Limited**

Butterfield Asset Management Limited (BAM), our investment management subsidiary, provides discretionary portfolio management for institutional and private clients and manages the award-winning family of Butterfield Funds, as well as the Bank's own investment portfolios.



*Butterfield Asset Management Limited, while based in Bermuda, receives valuable input from the investment teams in Guernsey (pictured above) and Cayman (at top).*

# SuperStars

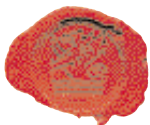


## *Butterfield Asset Management wins performance awards once again!*

For the last four years, Butterfield Asset Management has won top performance awards from Standard & Poor's (S&P) Micropal for its family of eight "in-house" managed mutual funds. These awards have been for the overall performance of all Butterfield Funds as well as its S&P AAAM rated Money Market Fund. Our other funds include: fixed income, balanced and equity. This confirms our experience and top quality management skills across our whole range of funds.

### **The awards from Standard & Poor's for our performance in 2000:**

- ★ **FIRST PLACE** in the World\* for the Five Year Performance of our Butterfield Money Market Fund (GBP Class).
- ★ **SECOND PLACE** in the World\*\* for the One Year Performance of our whole family of in-house managed mutual funds.



## **Butterfield Asset Management Limited**

A wholly owned subsidiary of The Bank of N. T. Butterfield & Son Limited, and licensed to conduct Investment Business by the Bermuda Monetary Authority.

**[www.bam.bm](http://www.bam.bm)**

Past performance does not guarantee future results.

Any offer or invitation for subscription or purchase of shares in the Funds will be made on the basis of a current prospectus.

Applications will only be considered on the basis of a duly completed application form.

\* Internationally Marketed Funds Survey \*\* Internationally Marketed Funds Survey – Smaller Groups Category

For the fourth year running, BAM has won top performance awards from Standard & Poor's Micropal (S&P) for its in-house-managed mutual funds. S&P awards are considered the global standard by which fund managers and investment groups are measured. For 2001, we were awarded second place in the world for overall one-year performance of our entire family of Butterfield Funds in the smaller group category. We also earned first place for five-year performance on the Butterfield Money Market Fund, Sterling Class.

The Butterfield Money Market Fund, rated AAAm by Standard & Poor's continues to attract new accounts at a rapid pace and posted record revenues during the period under review. Assets under management grew by 24.9% to \$2.7 billion. The US Dollar A Class produced a return of 5.8% for the 12 months ended 30 June 2001.

The Butterfield Liquid Reserve Fund, rated AAF by Standard & Poor's, grew by 84.0% during the year under review, reaching \$210.3 million in assets. It produced a return of 7.34% for the year. This short-term bond fund invests in US Dollar denominated short dated fixed and floating securities. The Butterfield Bermuda Fund grew by 65.1% to \$27.1 million, producing a return of 73.7% for 12 months. The Butterfield US Dollar Bond Fund has grown by 41.3% over the year and returned 10.4%, and our longest duration bond fund, Butterfield Capital Appreciation Bond Fund, grew by 10.0% and returned 11.3% over the year.

During 2001, assets under management grew at a record rate, rising by 18.9% to \$5.2 billion. Asset growth has led to a record net income, \$5.8 million, \$2.6 million over 2000. With the sharp rise in net income our efficiency ratio has improved to 60.9% from the prior year's 72.4%.

#### **Butterfield Corporate Services Limited**

Butterfield Corporate Services Limited (BCSL) provides specialist full service mutual and hedge fund administration and corporate services, such as accounting, valuation, reporting, compliance, corporate secretary and custodial services. We focus on providing third-party administration for offshore funds and act for a number of the world's leading investment management groups. We serve mostly institutional fund clients, including Butterfield Asset Management, which manages the Butterfield group of mutual funds.

For the year under review, BCSL worked in conjunction with the Bank's other fund services operations in the Cayman Islands, Guernsey and Hong Kong to develop a group identity, 'Butterfield Fund Services,' for its international marketing programmes. This focuses on the strengths of the Group as a whole. Business continues to grow at an impressive rate and BCSL itself now has \$14.0 billion under administration.

A new share registration system, NTAS, has been implemented and we continue to upgrade and update our processes and systems on an ongoing basis. Staffing has been increased to meet the influx of new business and ongoing training is a priority.



Our new 'Micro' Branch at the Waterfront Centre is an innovative banking concept. It combines modern technology with personal service by using two-way audio/video communication to provide interactive service from a remote teller.

THE BANK'S INVESTMENT PORTFOLIO BY LONG-TERM DEBT RATING



- 22% AAA
- 32% AA
- 40% A
- 5% BBB
- 1% BB

INVESTMENT PORTFOLIO BY COUNTRY OF ISSUER



- 65% USA
- 8% UK
- 18% Other OECD
- 5% Canada
- 4% Australia

Net income increased to a new record of \$1.1 million from the previous year's \$0.2 million. The efficiency ratio accordingly improved to 84.7% from the previous year's disappointing 96.5% and we are optimistic that this will continue to fall towards the Group average in the coming year.

New business from growing 'fund families' is expected to have significant benefits over the coming year. Customers of BCSL also provide substantial business to other areas of the Bank, such as BAM, Treasury and Corporate Banking.

**Butterfield Trust (Bermuda) Limited**

Butterfield Trust (Bermuda) Limited provides trust, estate, pension administration and employee benefits services as well as private banking. Butterfield Trust has continued to attract new clients and, this year, has been especially successful in broadening its business beyond the traditional personal trusts by attracting insurance-related trust business as well as commercial trusts for complex transactions.

Butterfield Trust produced a strong result for the year, although net income fell by 5.1% to \$4.8 million. The prior year net income was raised by several non-recurring special fees, without which the year-on-year comparative would have been significantly positive. In fact although slightly below the prior year, net income in 2001 was well ahead of our target for the year. Because of the slight decline in net income the efficiency ratio rose to 70.6% from the prior year 69.2%.



*Above: Management in Bermuda: Janet M. Nearon, Senior Vice President – Customer Relations; Ronald E. Simmons, Senior Vice President & Chief Accountant; and John Whale, Senior Vice President and Head of Treasury.*

Throughout the year, Butterfield Trust continued to develop and enhance its institutional and pension trust services, gaining several important new clients. We also implemented procedures and systems to comply with new US regulations concerning withholding tax and have received status as a Qualified Intermediary.

Professionalism and integrity are the keys to our success. We place high importance on developing close relationships with our clients – the settlors and beneficiaries of the trusts we handle. They and their advisors know they can communicate with and rely on our team’s experience and knowledge.

Our commitment to the highest standards of service is further enhanced through continuous development of our employees’ expertise. In addition to the Bank’s training programmes, one third of our staff members are completing the new education programmes offered by the Society of Trust and Estate Practitioners.

### **E-Commerce & Electronic Banking**

Our long experience with multi-jurisdiction and multi-currency transactions positions us to take advantage of new business opportunities presented by e-commerce and e-banking.

One of our most significant projects during the year under review was the development and implementation of Butterfield Direct Internet Banking, discussed previously under Retail Banking. It gives both retail and corporate customers the power, control and convenience of managing their money and performing transactions 24 hours a day, 365 days a year, using the Internet.

Other electronic banking products continue to contribute to the Bank’s success. We added three companies to our ATM bill payment programme, which allows customers to use our networked banking machines to pay their bills to local businesses.

Credit and debit cards continue to be a significant element in our electronic banking strategy. We repositioned our debit card product, BankCard Plus, as the Butterfield Card, to ensure consistent branding of the Bank’s products and services.

### **Our People**

We recognise the importance of a highly motivated, customer focused employee culture, and we provide employees with ample opportunities to gain key skills and knowledge that will help them meet Bank objectives and build their careers.

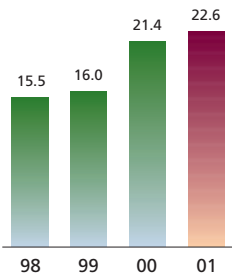
During the year under review, our training programmes, both internal and external, enabled 517 employees to enhance their capabilities. Our emphasis on recruiting and retaining Bermudian employees continued. Through the Management Training Programme, now in its third year, four university graduates joined the Bank. We also introduced a Retail Fast Track Programme, designed to attract high school graduates into careers in Retail Banking, and a Treasury Training Programme, which aims to produce qualified and competent traders. In both programmes, senior employees mentor trainees.



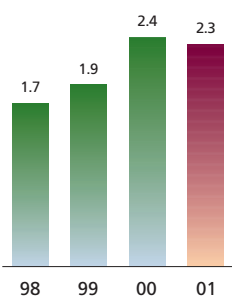
## Cayman Islands



CAYMAN  
NET INCOME (\$m)



CAYMAN  
RETURN ON ASSETS (%)



A thriving Caribbean offshore financial centre, the Cayman Islands have worked effectively for over 30 years to attract international business, especially banking, trust, captive insurance and mutual fund administration. A very sophisticated and diversified financial infrastructure has been developed over the years, enhancing Cayman's image as one of the leading offshore financial centres in the world. The Cayman Islands, a United Kingdom overseas territory with a population of about 40,000, are also a popular tourist destination.

The objective of Bank of Butterfield International (Cayman) Ltd. is to be the pre-eminent financial institution in the Cayman Islands in both the domestic market and the international offshore market. We offer a comprehensive range of community and commercial banking services to private and corporate customers and, in addition, provide portfolio management, stock brokerage, trust and company administration, mutual fund and pension fund administration services.

On 22 June 2001, the Cayman Islands were removed from the FATF blacklist following a year-long effort by legislators, law enforcement officials, regulators and the private sector addressing perceived shortcomings in the financial system. The removal from the listing is very encouraging for our Cayman presence.

Net income in our Cayman operation rose 5.6% to \$22.6 million, marking the 13th consecutive year of sustained growth and maintaining Cayman's key contribution to the parent company's consolidated earnings performance. Total revenue grew by 11.5% with an efficiency ratio of 45.9% and a return on equity of 19.8% for the year.

We maintain a very strong balance sheet in Cayman, both in terms of the capital base, built through retained earnings, and the quality of its assets. Assets are comprised of money market placements, loans and a floating rate note portfolio, which is rated Af (credit) and S1 (volatility) by Standard & Poor's. Our strong balance sheet helps us maintain stability in our business and gives depositors confidence in our institution.



Main Office, Cayman Islands



### **Community Banking**

With five branches to serve our customers, our Community Banking activities in the Cayman Islands represent a core activity. The contribution of this business to overall earnings continues to be strong, achieving a 15.2% increase in net income.

### **Personal Banking**

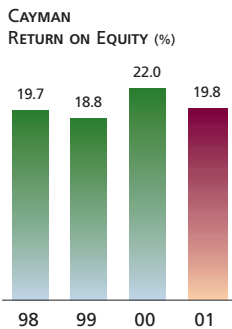
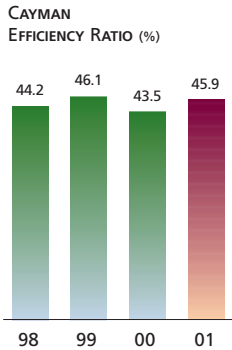
We continue to attract profitable personal banking business helped by our strong reputation for customer service and steady growth in the population of the Cayman Islands. This year we introduced services that encourage customers to use our efficient and cost-effective electronic delivery channels. We introduced our first drive-through ATM, located adjacent to Butterfield House and we launched a Cayman Islands Dollar denominated VISA debit card. Our seven ATMs now accept VISA and Plus network cards for cash withdrawals, adding to our transaction volumes and fee-based revenue.

### **Corporate Banking**

Our Corporate Banking team is working effectively to enhance customer relationships and promote our range of banking, credit and investment services to the corporate community. Corporate Banking promotes Butterfield Online as Cayman's first online banking service to our corporate customers. This worldwide electronic access channel provides an Internet link to our banking products via an easy-to-use web-based browser.

### **Credit Services**

We continued to experience strong credit demand, with year over year growth of 19.6% in the loan portfolio. This growth was achieved while maintaining quality and improving service levels. We continue to be a leading player in the residential mortgage market and demand for mortgages has remained strong.



## Asset Management and Administration

### Investment Services

Our Cayman operation's investment services department provides discretionary portfolio management for institutional and private clients, stock brokerage and safe custody services. The department experienced solid year over year increases in asset based fees, but declines in trading activity and, consequently, brokerage revenues, resulting in a moderate decline overall. Financial markets remain under pressure from slowing growth in the economies of many western nations and have negatively impacted brokerage revenues.

Our assets under management for 2001 were \$327 million and our income was \$4.1 million.

The two Butterfield Funds managed by the Cayman office, Butterfield International Balanced Fund and Butterfield Global Blue Chip Fund, performed well against their index allocation benchmarks, and the number of unitholders/shareholders increased 5.5% and 16.3% respectively.

Butterfield International Balanced Fund retained its Five Star Rating from Standard and Poor's and remains the top fund in its S & P class in the three-year return category.

Industry-leading investment management software was implemented, allowing us to offer enhanced reporting and services to our customers and providing a sophisticated portfolio management platform for the Bank, thereby enhancing our capabilities. This investment is a reflection of the commitment that our Cayman office has to this core business.

### Trust & Corporate Services

Trust and Corporate Services experienced revenue growth of 6.6% with total revenue of \$3.2 million and assets under administration of \$6.5 billion. The main services offered to personal clients include wealth management, through the establishment and administration of trusts and companies, and estate administration. Services offered to institutional clients include company formation and administration, managed bank and trust company services and administration of employee benefit plans.

Right: Management in Cayman, l-r:  
Conor J. O'Dea, Managing Director,  
Bank of Butterfield International  
(Cayman) Ltd.; Sheree L. Ebanks,  
Director and Senior Manager of  
Investment Services; and  
Barry J. Yetton, Director and Senior  
Manager of Treasury.



The managed bank business is a major contributor to revenues, with good prospects for sustained growth. We experienced strong revenue growth from existing relationships with highly reputable financial institutions, and a significant managed banking relationship has been re-established with services commencing early in the new year. The relationship we have with these large, reputable institutions is a reflection of our commitment to service.

The company management and trust business shows steady revenue growth through new and existing clients. We continue to explore new opportunities and strengthen relationships to ensure continued growth of the personal and institutional business.

#### **Mutual Fund & Pension Fund Administration**

The Cayman office provides full administration services to mutual funds and pension funds and achieved strong growth of 24.0% in revenues this year with total revenues of \$2.5 million and funds under administration of \$4.2 billion. In addition to providing these services to third parties, we act as administrator, registrar and transfer agent to the Butterfield International Balanced Fund and the Butterfield Global Blue Chip Fund.

Good levels of new business were achieved from existing and new sources. Relationships with professional intermediaries at a local and international level are being further developed and will provide solid new business growth.

#### **Our People**

We know our future success in the competitive Cayman market will be determined, to a large degree, by the skills and leadership of our people. Because of that, employee development and training are a priority.

This year, several of our employees successfully completed programmes such as the Foundation Banking Diploma, Foundation Banking Certificate and the CI Bankers Association's Introduction to Private Trusts. A number of our employees are enrolled in banking and trust courses by correspondence with the Institute of Canadian Bankers, Chartered Institute of Bankers and Society of Trust and Estate Practitioners.

During 2001, the Bank also provided special development and education programmes in-house, including "Leading the Revolution" and "Leadership Principles," for management employees and supervisors respectively. Other courses included "English in the Workplace," and a half-day course on anti-money laundering procedures, led by the CI Bankers Association.

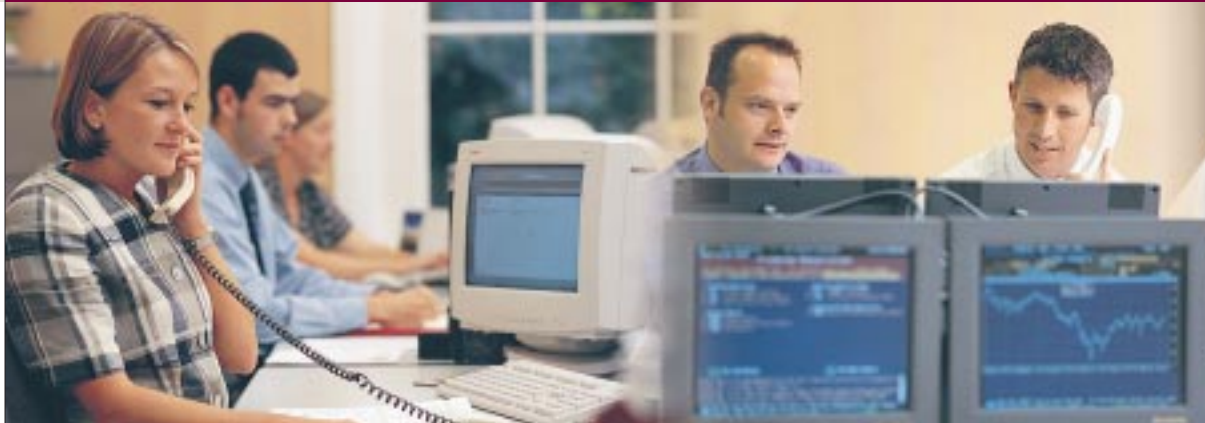
Independently and through the CI Bankers Association, we also participated in three events for High School students, offering information about careers in banking and, specifically, with Bank of Butterfield.

Our employees are willing and enthusiastic participants in these programmes and we appreciate their commitment to lifelong learning.

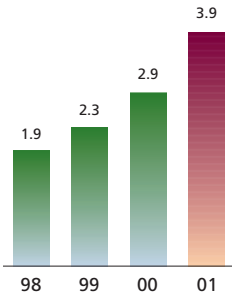




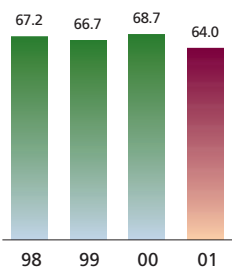
# Guernsey



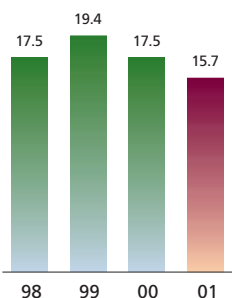
GUERNSEY NET INCOME (\$m)



GUERNSEY EFFICIENCY RATIO (%)



GUERNSEY RETURN ON EQUITY (PRE-TAX) (%)



Guernsey, in the Channel Islands, is a long-established and highly competitive financial centre, with particular expertise in the areas of banking, investment management, trustee services, captive insurance and mutual fund administration. Guernsey has been assessed by recent independent reviews on behalf of the UK Home Office and the G7 Financial Action Task Force as being in the top tier of offshore jurisdictions.

The Group's presence in Guernsey dates back almost 30 years, and our successful businesses provide a broad range of services to private clients and financial institutions. Services include investment management and custody, banking and treasury, trust services and third-party fund administration.

After the end of the 2001 fiscal year, Bank of Butterfield International (Guernsey) Limited and Butterfield Fund Managers (Guernsey) Limited acquired the Guernsey operations of the Canadian Imperial Bank of Commerce, an important acquisition that strengthens our presence and builds our business significantly in this jurisdiction.

For fiscal 2001, the Guernsey office's total revenue was \$13.7 million, up by 19.9% from \$11.4 million the previous year. After-tax net income was \$3.9 million, up 31.3% from \$2.9 million, year over year. This was the 11th consecutive year of income growth. Guernsey's efficiency ratio was 64.0%, improved from 68.7% a year ago. The pre-tax Return on Equity, at 15.7%, was down from 17.5% the year before due to the increase in shareholder's equity necessary to facilitate the acquisition of ANZ Bank (Guernsey) Limited.

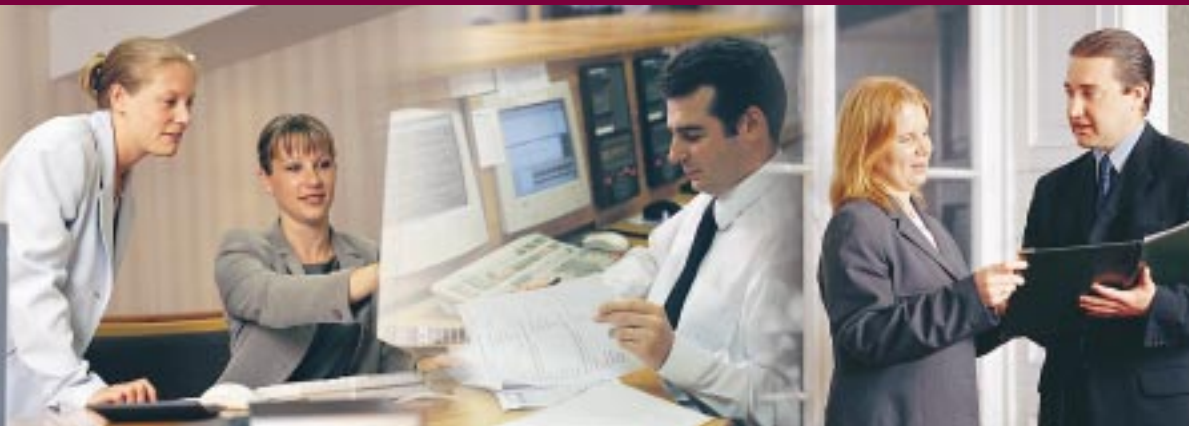
Our acquisition, in 2000, of ANZ Bank (Guernsey) Limited, was consolidated during this past year. We have retained a very high proportion of this business and developed deeper relationships with these clients.

2001 was a year of continuing business growth, particularly with regard to new accounts established by private clients and new fund administration and institutional custody business. The growth in client assets was 29.0% and the loan portfolio grew by \$4.9 million, or 5.7% to \$91.1 million. Net interest income and revenue from fee-based services both grew substantially.





Main Office, Guernsey



Revenues from trust, investment and corporate services grew by \$0.5 million, or 13.7%, over 2000. Assets managed under discretionary mandate, client holdings in the various Butterfield Funds and securities held in custody all rose strongly this year. Assets under administration were \$0.8 billion, up 17.3% on the previous year.

Butterfield Trust (Guernsey) Limited performed well, increasing profitability by 39.0% over the previous year. Private client trusteeship is the principal service offered by Butterfield Trust (Guernsey) Limited, along with company administration services. Trusteeship of offshore Employee Benefit Trusts was an important aspect of the business in 2001.

*Below: Management in Guernsey, l-r: Robert S. Moore, Managing Director; Raymond A. Bushell, Director – Finance, Systems & Operations; Andrew R. Collins, Managing Director – Butterfield Fund Managers (Guernsey) Limited; Neil E. Farrand, Senior Manager – Treasury and Credit Services and Karen E. Winter, Director – Investment Services.*

Butterfield Fund Managers (Guernsey) Limited (BFM), which focuses on the provision of specialist, third-party fund administration services, experienced significant business growth. This growth can be attributed to the attractiveness of the European time zone for certain fund promoters and investor groups, as well as the strong reputation of Guernsey as a jurisdiction. Assets under administration by BFM stood at \$2.6 billion at the financial year-end.

A record number of our Guernsey employees embarked on a variety of professional qualifications during 2001, reflecting the Bank's emphasis on learning and development. We also took the decision to seek Investors in People accreditation, which helps organisations make the most of their investment in employee development by ensuring their training programmes and practices are aligned with their objectives and goals.

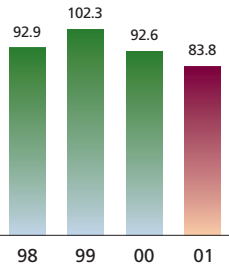




## Hong Kong



HONG KONG  
EFFICIENCY RATIO (%)

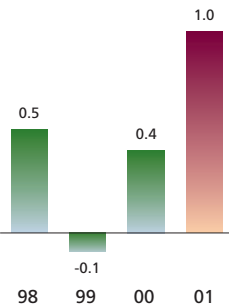


The Group's Hong Kong subsidiaries provide third-party fund administration, custody, provident fund and other corporate services. A restricted licence branch supports these activities with treasury and foreign exchange services. The Hong Kong office also serves as an important local contact for business referred from the Asia-Pacific region to our offices in Bermuda, Cayman and Guernsey, particularly for those companies setting up and maintaining an offshore domicile.

During 2001, the Hong Kong businesses achieved significant growth. Profit, at \$1 million, rose by 152.3%. Total income, at \$6.3 million, grew 16.9%, with expenses increasing by only 5.9%. Our efficiency ratio was 83.8% compared to 92.6% the previous year.

We experienced growth in administrative fee income and reduced our reliance on transaction fees. The income stream is now more stable and we have been able to sustain and improve profitability during the current market decline. When the market improves, we are positioned to generate additional revenue without a corresponding increase in costs.

HONG KONG  
NET INCOME (\$m)



Our focus, throughout 2001, has been to build on success. We have attracted new clients and are developing profitable relationships through a strategy of winning business based on quality service at the right price. In developing significant new client relationships under Mandatory Provident Fund (MPF) legislation implemented this year, we are providing trustee and fund administration services to approximately 20% of the market as measured by annual contributions.

We have also attracted a growing number of Hong Kong listed companies as profitable corporate management clients and improved our business levels in mutual funds/administration and custody. Building on our existing core activities, we have introduced Employee Benefit and Share Ownership Trusts and new structured products using custody and share registration services. Business introductions continue to generate revenue for the Bank's international offices.



Our local profile has improved through the participation of our senior management in key industry associations and regulatory committees. In addition, we have strategically participated in or sponsored a number of seminars and conferences that specifically addressed financial industry issues.

We are also committed to developing and encouraging excellence in our work force. We emphasise internal promotion and have made a number of internal transfers and promotions that take advantage of employees' skills and broaden their experience. One of our employees this year achieved the professional designation of the Hong Kong Institute of Bankers. Two others successfully achieved the Compliance Practitioners Certificate (CPC), a new industry qualification issued by the Hong Kong Securities Institute. More than half our employees hold university degrees. We know a committed, competent and knowledgeable work force will be a key to our success in this competitive market, and our employees' ability to anticipate clients' needs – and meet them – can be our strategic advantage.

Main Office, Hong Kong (top)

Right: Management in Hong Kong, l-r: Austin R. Caffrey, Chief Executive, Hong Kong; Ian Leung Tat Ming, Operations Director; and Alastair E. Murray, Managing Director, Butterfield Trust (Hong Kong) Limited.





## United Kingdom



Bank of Butterfield Group entered the substantial and well regulated United Kingdom market in February 2001 by the purchase of Matheson Bank, London, which has been renamed Bank of Butterfield (UK) Limited.

The bank has a well deserved reputation for high quality customer service and efficient administration, and the range of services currently offered to customers includes deposit taking, secured lending, foreign exchange and global custody of securities.

This acquisition, which is in line with our strategy of building on existing core activities and strengths, will be used as a platform for future, focused growth in the United Kingdom.

Bank of Butterfield (UK) Limited maintains a stable, highly liquid balance sheet.

*Left: Management  
in United Kingdom:  
Alan S. Gray,  
Managing Director.*



At Bank of Butterfield, we know a business is as good as its people – and we are working to make sure our people are the best.

We are committed to maintaining a motivated, capable workforce, a diverse group of men and women dedicated to the Bank's goals of outstanding customer service and efficient, effective performance.

We recruit carefully and continue to develop employees once they are hired. We extend their technical and business skills, their customer service focus and their management and leadership competence through external education programmes, on-the-job coaching and cross-functional postings. People know there is an interesting and rewarding career path for those willing to make the commitment and work hard.

Our business and financial success this year is directly related to the success of our 1,162 employees. It is through their work that the Bank is making progress towards its goals.



## Financial Overview

### INCOME

Total income for the Group was \$192.0 million for the year ended 30 June 2001, up \$11.1 million, or 6.2%, from \$180.9 million in 2000.

Continued progress has been made on reducing the size of our non-accrual loans, in respect of continuing operations. They were reduced from \$11.0 million at 30 June 2000, to \$9.5 million at 30 June 2001, representing 0.7% of total loans. In addition, the Group's average interest earning assets increased by \$343.2 million, or 7.8%, which resulted in enhanced interest earning. Net interest income was \$100.2 million, up 2.8% from \$97.5 million in 2000.

In the fiscal year the Bank recognised a loss of \$6.0 million from discontinued operations emanating from a portfolio of loans remaining from a discontinued business in the United Kingdom. There are now no loans remaining from discontinued operations.

The Group's customer deposit base increased significantly during the year under review, up \$502.6 million, or 12.7%. This was mainly due to the successful acquisition in February of Matheson Bank Limited in the United Kingdom, now renamed Bank of Butterfield (UK) Limited. This acquisition increased customer deposits by \$255.8 million. In addition, increases in customer deposits were also achieved in Bermuda (+\$123.4 million), Cayman (+\$97.6 million) and Guernsey (+\$29.5 million). The increase in customer deposits has enabled the Group to reduce its utilisation of funding from the wholesale money and repo markets, down year on year by \$139.2 million, or 32.3%, and increase both deposits with banks, up \$176.6 million or 11.7%, and investments, up \$51.2 million, or 2.8%. Despite the decline seen in interest rates in the world's major markets during 2001, both the Group's net interest margin and spread remained healthy, at 2.1% and 1.8% respectively. Non-interest income grew to \$91.8 million, up 10.1% from \$83.4 million last year. This reflects the Group's continued efforts to raise non-interest revenue, as a percentage of total income, particularly in the area of corporate services and trust and executorship fees. Record income from foreign exchange, investment and corporate services contributed to the growth in this area.

Income from fees and other non-interest sources now accounts for 47.8% of our total income compared to 46.1% last year. This income is important, given that it does not require significant amounts of capital to support it and ensures diversification of earnings.

DISTRIBUTION OF TOTAL INCOME



52.2%	Net Interest Income
14.6%	Fees, Commissions & Service Charges
7.5%	Trust & Executorship Fees
9.8%	Investment Services Revenue
6.6%	Corporate Services Revenue
7.3%	Foreign Exchange Revenue
2.0%	Other Income

DISTRIBUTION OF NET INCOME FROM CONTINUING OPERATIONS BY LOCATION



58.4%	Bermuda
33.8%	Cayman
5.8%	Guernsey
1.5%	Hong Kong
0.5%	UK

## Fee Income

For the year ended 30 June (In \$ thousands)

	2001	2000	% change
Fees, commissions and service charges	28,006	25,028	11.9
Trust and executorship fees	14,428	15,216	-0.5
Investment services revenue	18,797	16,403	14.6
Corporate services revenue	12,716	10,526	20.8
Foreign exchange revenue	14,066	13,133	7.1
Other income	3,762	3,062	22.9
<b>Total Fee Income</b>	<b>91,775</b>	<b>83,368</b>	<b>10.1</b>

## Changes in Net Interest Income

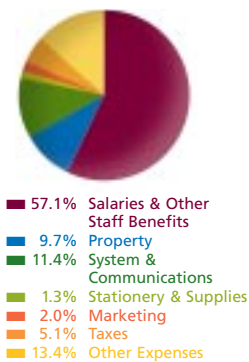
For the year ended 30 June (In \$ thousands)

	2001			2000		
	AVERAGE BALANCE	INTEREST	RATE	AVERAGE BALANCE	INTEREST	RATE
<b>Assets</b>						
Cash and deposits with banks	1,534,191	89,632	5.8%	1,327,551	78,821	5.9%
Investments	1,870,551	113,323	6.1%	1,813,237	111,598	6.2%
Loans	1,357,534	107,524	7.9%	1,278,355	108,671	8.5%
Earning assets	4,762,276	310,479	6.5%	4,419,143	299,090	6.8%
Other assets	171,400	–	–	168,746	–	–
<b>Total Assets</b>	<b>4,933,676</b>	<b>310,479</b>	<b>6.3%</b>	<b>4,587,889</b>	<b>299,090</b>	<b>6.5%</b>
<b>Liabilities</b>						
Deposits	4,443,067	201,195	4.5%	3,991,173	185,565	4.6%
Repurchase agreements	70,912	3,668	5.2%	196,372	10,829	5.5%
Subordinated debt	75,000	5,403	7.2%	75,000	5,209	6.9%
Interest bearing liabilities	4,588,979	210,266	4.6%	4,262,545	201,603	4.7%
Other liabilities	76,639	–	–	79,352	–	–
<b>Total Liabilities</b>	<b>4,665,618</b>	<b>210,266</b>	<b>4.5%</b>	<b>4,341,897</b>	<b>201,603</b>	<b>4.6%</b>
<b>Shareholders' Equity</b>	<b>268,058</b>			<b>245,992</b>		
<b>Total Liabilities and Shareholders' Equity</b>	<b>4,933,676</b>			<b>4,587,889</b>		
<b>Spread</b>			<b>1.8%</b>			<b>1.9%</b>
<b>Net Interest Margin</b>			<b>2.1%</b>			<b>2.2%</b>

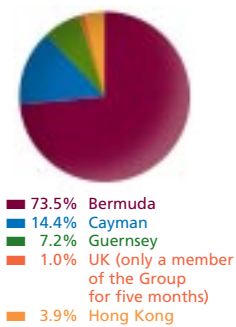
Note: Underlying assets and liabilities are comprised of various currencies.



DISTRIBUTION OF TOTAL EXPENSES



DISTRIBUTION OF EXPENSES BY LOCATION



### EXPENSES

Operating expenses were reduced by 0.6% during the year under review, dropping to \$125.3 million from \$126 million in 2000. A major reason for this improvement was a one-time credit in respect of our pension expense of \$2.8 million. However, cost efficiencies were achieved and salaries only increased by \$0.9 million, or 1.7%.

A large share of expense was associated with our Bermuda based operations, which accounted for 73.5% of Group costs (2000: 74.8%) but contributed only 68.5% of Group revenue (2000: 68.0%). Considerable progress was made in closing the gap during fiscal 2001 and we are seeing signs that measures we are taking to ensure efficiency through process improvement and investment in technology and employee development will continue this trend.

At the close of the financial year, we had 1,162 employees (full time equivalent), up from 1,113 last year, partly due to the acquisition in London and expansion in Cayman (+25), Guernsey (+13) and Hong Kong (+10), offset by a reduction of 18 personnel in Bermuda. We have examined how our human resources are used and assigned people where they can be most effective. In 2001 this resulted in continued improvement in employee productivity across the Group, with the average profit for the year per employee rising to \$52,000 in Bermuda (2000: \$48,000) and \$73,000 for our overseas operations (2000: \$72,000).

### ASSETS

Total assets have increased to \$5.2 billion from \$4.8 billion a year ago. This reflects the acquisition of Matheson Bank and increased customer deposits in both Bermuda and Cayman.

### TAXES

In 2001, Group taxes on income earned in Guernsey and the United Kingdom totalled \$0.5 million, down 73.0% from \$1.9 million in 2000. In Guernsey the Group received a tax credit of \$0.7 million in respect of the amalgamation of ANZ Bank (Guernsey) Limited in 2000, which reduced taxes paid in Guernsey by \$0.4 million year on year. The year-on-year reduction in profit taxes also reflects the sale of our Davenham operation, in June 2000, offset by the acquisition of Matheson Bank, in February 2001. We also paid \$5.4 million in non profits taxes in Bermuda, and \$0.3 million in Cayman Islands. Although the Governments of Bermuda and Cayman Islands do not collect profits tax, they maintain efficient and appropriate indirect taxation systems to finance normal Government activities.

### Capital Composition (In \$ thousands)

	2001	2000
Tier 1 Capital	278,742	242,077
Tier 2 Capital	95,576	91,587
<b>Total Capital</b>	<b>374,318</b>	<b>333,664</b>

### Weighted Risk Assets (In \$ thousands)

Cash and inter-bank placements	348,131	309,258
Investments	728,483	774,174
Loans	1,020,236	996,649
Other assets	157,614	156,164
Off-balance sheet items	280,610	296,690
<b>Total Weighted Risk Assets</b>	<b>2,535,074</b>	<b>2,532,935</b>

### Capital Ratios

Tier 1	11.0%	9.6%
Tier 2	3.8%	3.6%
<b>Total</b>	<b>14.8%</b>	<b>13.2%</b>

## CAPITAL AND LIQUIDITY

The Group maintains a very strong capital base that ensures stability and allows us to take advantage of opportunities for growth. Retained earnings, after dividends declared of \$20.5 million, were \$39.6 million for the year. During the course of the year the Bank purchased 420,637 shares under the Share Buy-back Plan at a cost of \$8.6 million. Shareholders' equity has increased by \$36.3 million, or 14.5%, over last year.

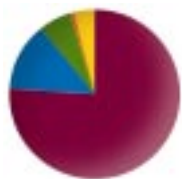
At 30 June 2001, the Bank's risk weighted total capital ratio was 14.8%, with Tier 1 Capital at 11.0% and Tier 2 Capital at 3.8%. This compares with last year's ratios of 13.2%, 9.6% and 3.6% respectively. While total assets increased by \$403.8 million, weighted risk assets only increased modestly by \$2.1 million to \$2.5 billion. This reflects a reduction in high risk weighted off-balance-sheet items and an increase in lower risk weighted assets such as cash and interbank placements. Our liquidity position remains strong, with high quality liquid assets now accounting for 68.8% of total assets.

## MANAGING RISK

Risk management is the cornerstone of the Group's business. Most of the routine activities undertaken daily involve risk, whether on behalf of customers or the Bank itself. Risk management involves controlling the risks inherent in the regular con-



LENDING BY LOCATION



76.81%	Bermuda
13.07%	Cayman
6.22%	Guernsey
0.03%	Hong Kong
3.87%	UK

BERMUDA LOANS BY TYPE



43.2%	Mortgages – Residential
3.1%	Mortgages – Commercial
11.6%	Personal
36.2%	Commercial Business
3.5%	Overdrafts
2.4%	Credit Cards

duct of business. It also involves monitoring the external environment for factors such as economic, political and industry change.

The Board’s Risk Policy Committee is the focal point for the coordinated review of risk. It ensures that Management achieves its aim of appropriately balancing risk and reward with attention to credit, market, liquidity and other risks.

**Credit Risk**

Credit risk encompasses all forms of counter party exposures. Counter parties may default on their obligations to the Group in relation to lending, trading, hedging, settlement and other financial activities.

Total loans at 30 June 2001 amounted to \$1.45 billion, up from \$1.28 billion a year ago. This reflects quality loan growth across the Group’s core businesses. Loans now represent 27.9% of assets, up from 26.8% last year. The loan portfolio remains well diversified. During the year, the Credit Risk Management team continued to reduce the Group’s non-accrual loans from \$18.8 million to \$9.5 million. Our prudent approach to provisions continued with our general loan provision set at \$20.6 million, up from \$16.6 million a year ago. This represents 1.4% of the total loan portfolio.

For all but the smallest loans, a clear separation exists between the officers recommending credit-related transactions and those who authorise them. Large credits are subject to review and authorisation by the Credit Committee, which benefits from the skill and experience of several executive officers.

Credit Risk Management and the Credit Committee, which is chaired by the President and CEO, have responsibility for the policies, mechanisms, organisation and procedures required to analyse, manage and control credit risk. The Group’s Credit Risk Policy Committee and Board of Directors receive regular reports on credit risk. The Credit Risk Management department continues to ensure that credit decisions are timely and efficient while protecting the Group’s position regarding risk.

Loans in Bermuda remain the largest portion of the Group’s overall lending gross of provisions, at 76.8% of the total portfolio. This portfolio consists primarily of personal lending, through residential mortgages, consumer and education loans, with the remainder in local corporate lending.

Residential mortgage lending in Bermuda was \$489.5 million, up 6.4% from \$460.1 million in 2000. Lending by our businesses outside Bermuda was up 38.1% to \$342.4 million from \$247.9 million in 2000.

## **Market Risk**

The Group's market risk is associated with price risk due to changes in interest rates, foreign exchange rates and related volatility. Market risk is also associated with liquidity risk. The Group manages market risk through appropriate centralised controls and reporting systems as well as direct involvement of experienced employees in all the jurisdictions where it operates. Front and back office duties are segregated and limits reviewed and approved.

The Group uses Value at Risk (VAR) methodology for management and daily monitoring of risks related to trading activities. The Group Asset and Liability Management Committee (GALCO) plays an integral role in identifying, reviewing and managing key financial strategic exposures. Its emphasis is on controlling risk while optimising the return on risk-adjusted capital and enhancing shareholder value. The Risk Policy Committee of the Board receives regular reports on market and liquidity risk.

Again this year, Standard & Poor's, the pre-eminent credit rating agency, monitored and rated the Bank's debt securities portfolios with regard to their credit and price volatility characteristics. All portfolio ratings have been maintained throughout the year. (See table on page 3.)

## **Interest and Exchange Rate Risk**

One of the objectives of asset and liability management is to manage and control the sensitivity of the Group's net interest revenue to changes in market interest rates. Balance sheet modelling and scenario analysis are used to manage 'structural' interest rate risk, using gap analysis. The Group's policy is to stabilise the sensitivity of net interest income against the impact of adverse rate movements. Hedging strategies, using both cash and swap instruments, have been used. In the area of interest rate risk arising from trading activities, the Group's appetite has traditionally been very conservative. We have primarily sought to capitalise on traditional customer flows for the generation of treasury earnings. The dealers operate on modest mismatch gap limits and foreign exchange open positions, with positions monitored using VAR methodology. Off-balance-sheet instruments are principally used for hedging, including interest rate swaps, forward rate agreements, forward foreign exchange contracts and financial futures.



Exposure to exchange rate movements in trading portfolios is also subject to VAR analysis. Exchange rate risks from lending activities are limited because the Group's operating units are decentralised and are required to hedge the currencies in which their assets and liabilities are denominated. Any short or long positions are monitored to ensure compliance with limits established by GALCO. Transaction exposure is managed as part of daily trading positions under foreign exchange limits unless a special situation exists for which GALCO would determine strategy. As the Group's balance sheet and earnings are primarily in Bermuda or US Dollars there are minimal structural currency exposures.

Proprietary foreign exchange trading activities are largely concentrated in the major trading currencies and in the spot markets, with minimal trading in the forward market. Extensive use is made of direct-dealing capabilities with international brokers in New York, London and Hong Kong, as well as Reuters Dealing and Electronic Broker Service systems for the execution of trades. Treasury uses a full range of financial market information providers. The Chief Financial Officer oversees the Group's interest and foreign exchange rate risk positions and reports to GALCO and the Risk Policy Committee.

### **Liquidity Risk**

Liquidity risk arises from fluctuations in the Group's cash flows. The Group is responsible for ensuring it is capable of absorbing these fluctuations while meeting all of its obligations as they fall due. The Group manages liquidity conservatively, at all times, in accordance with established policies for both the asset and liability sides of the balance sheet. This includes carefully measuring and forecasting cash commitments, continuing to build a stable base of deposits, ensuring that large pools of liquid assets are immediately available and maintaining a credit rating that enables the Group to borrow funds cost effectively and at short notice. Executives review current positions daily and recommend appropriate actions. Contingency plans are maintained to address potential liquidity crises. The Group maintains large holdings of highly liquid assets. Liquidity is managed on a Group basis by Treasury, overseen by the Chief Financial Officer and reviewed by GALCO.

### **Derivative Products**

Derivative products are financial contracts the value of which is derived from the price level of an underlying asset or liability, linked to interest rates, exchange rates or indices. Swaps, forwards and options are all types of derivatives. Derivatives are a risk management tool for the Group and its customers and are subject to the same risks as their underlying financial instruments, namely credit, liquidity, market and operating risk (see note 11 to the Consolidated Financial Statements for discussion of Derivative Financial Instruments).

The Group employs VAR methodology and inter-day evaluation of limits. Unit managers and local treasurers monitor positions daily and reports are forwarded on a daily basis to the Group's Head of Treasury and the Chief Financial Officer. Treasury risk control includes separate front, middle and back office reporting lines and responsibilities.

### **LEGAL RISK**

Legal risk arises from the uncertainties about the legal enforceability of the obligations of the Group's customers and counter parties, as well as the possibility that legal or regulatory changes may adversely affect the Group's position. The Group seeks to mitigate legal risk through the use of industry standard legal agreements, as well as consultation with counsel in the jurisdictions in which it does business.

### **OPERATING RISK**

Operating risk is the risk of loss caused by internal or external events, such as procedural failures, errors or fraud that affect the Group's systems, controls and management processes. Procedures and systems are designed to ensure a high degree of separation of duties and built-in controls. A key feature of the Group's organisation is the independence of its internal audit functions, which report directly to the senior officer in each jurisdiction in which we do business. In Guernsey, Hong Kong and London the internal audit function has been out-sourced to a leading accounting firm. In each operation, including Bermuda and Cayman, the Head of Internal Audit has direct access to the Board of Directors.

### **TECHNOLOGY RISK**

The use of automated systems is increasingly central to transaction processing, management information and the application of internal controls, thereby reducing the risk of error. The Bank is making significant ongoing investments, in both front and back office systems, to improve the efficiency and the security of these processes.



## Selected Quarterly Results of Operations

(Unaudited, in \$ thousands except share data and ratios)	2001			
	Q4 30/6/01	Q3 31/3/01	Q2 31/12/00	Q1 30/9/00
<b>Net interest income</b>	27,788	26,037	22,716	23,672
<b>Total fees and other income</b>	24,500	22,891	23,059	21,325
<b>Total income</b>	52,288	48,928	45,775	44,997
<b>Total expenses</b>	36,144	27,287	31,105	30,720
<b>Net income from continuing operations</b>	16,144	21,641	14,670	14,277
Profit (loss) from discontinued operations	288	(6,278)	–	–
<b>Net income for the quarter</b>	16,432	15,363	14,670	14,277
<b>Earnings per share (\$)</b>				
Including discontinued operations	0.93	0.88	0.83	0.81
Excluding discontinued operations	0.92	1.23	0.83	0.81
<b>Return on shareholders' equity (%)</b>	23.4	22.8	22.2	22.2

(Unaudited, in \$ thousands except share data and ratios)	2000			
	Q4 30/6/00	Q3 31/3/00	Q2 31/12/99	Q1 30/9/99
<b>Net interest income</b>	25,864	31,119	20,198	20,306
<b>Total fees and other income</b>	19,241	23,043	21,306	19,778
<b>Total income</b>	45,105	54,162	41,504	40,084
<b>Total expenses</b>	34,160	29,397	31,740	30,671
<b>Net income from continuing operations</b>	10,945	24,765	9,764	9,413
Loss from discontinued operations	–	(14,540)	–	–
<b>Net income for the quarter</b>	10,945	10,225	9,764	9,413
<b>Earnings per share (\$)</b>				
Including discontinued operations	0.62	0.56	0.53	0.51
Excluding discontinued operations	0.63	1.35	0.53	0.51
<b>Return on shareholders' equity (%)</b>	17.5	16.7	15.8	15.4