



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.

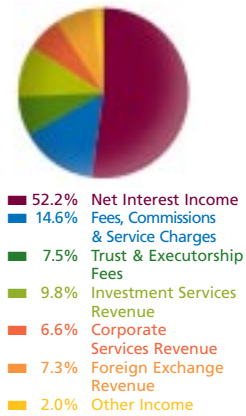
Continued progress has been made on reducing the size of our non-accrual loans, in respect of continuing operations. They were reduced from \$11.0 million at 30 June 2000, to \$9.5 million at 30 June 2001, representing 0.7% of total loans. In addition, the Group's average interest earning assets increased 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.

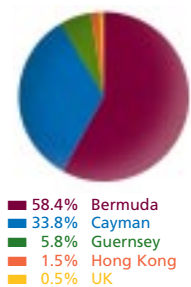
The Group's customer deposit base increased significantly during the year under review, up \$502.6 million, or 12.7%. This was mainly due to the successful acquisition in February of Matheson Bank Limited in the United Kingdom, now renamed Bank of Butterfield (UK) Limited. This acquisition increased 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



DISTRIBUTION OF NET INCOME FROM CONTINUING OPERATIONS BY LOCATION



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
Total Fee Income	91,775	83,368	10.1

Changes in Net Interest Income

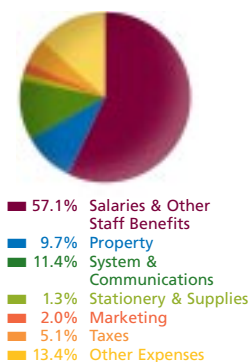
For the year ended 30 June (In \$ thousands)

	2001			2000		
	AVERAGE BALANCE	INTEREST	RATE	AVERAGE BALANCE	INTEREST	RATE
Assets						
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	–	–
Total Assets	4,933,676	310,479	6.3%	4,587,889	299,090	6.5%
Liabilities						
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	–	–
Total Liabilities	4,665,618	210,266	4.5%	4,341,897	201,603	4.6%
Shareholders' Equity	268,058			245,992		
Total Liabilities and Shareholders' Equity	4,933,676			4,587,889		
Spread			1.8%			1.9%
Net Interest Margin			2.1%			2.2%

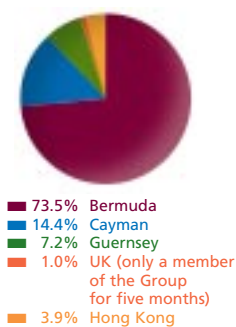
Note: Underlying assets and liabilities are comprised of various currencies.



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
Total Capital	374,318	333,664

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
Total Weighted Risk Assets	2,535,074	2,532,935

Capital Ratios

Tier 1	11.0%	9.6%
Tier 2	3.8%	3.6%
Total	14.8%	13.2%

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.

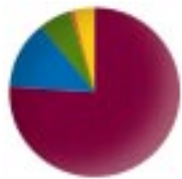
At 30 June 2001, the Bank's risk weighted total capital ratio was 14.8%, with Tier 1 Capital at 11.0% and Tier 2 Capital at 3.8%. This compares with last year's ratios of 13.2%, 9.6% and 3.6% respectively. While total assets increased by \$403.8 million, weighted risk assets only increased modestly by \$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.