

## Income

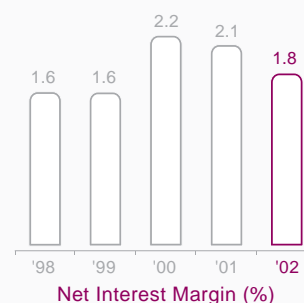
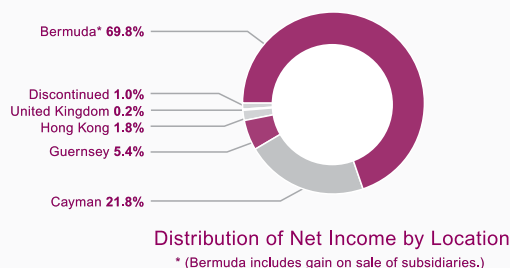
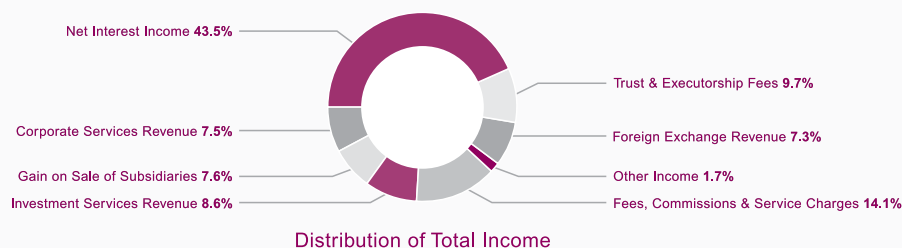
Total income for the Group was \$223.6 million for the year ended 30 June 2002, up \$31.6 million, or 16.5%, from \$192.0 million in 2001. Included in total income is the \$17.0 million gain from the sale of our Hong Kong subsidiaries. Excluding that net gain, total income was up \$14.6 million, or 7.6%.

Net interest income, after credit-related provisions, declined by 3.0% to \$97.2 million, reflecting the low level of interest rates in both the US and UK. While the Group's average interest earning assets increased by 12.1% to \$5.3 billion, reflecting the acquisition of CIBC's Guernsey operations, the net interest margin declined by 0.3% to 1.8% as a direct result of interest rate declines. However, we were able to maintain the interest rate spread, at 1.5%, through margin management and anticipate an improved net interest margin for the rest of the calendar year due to our asset/liability management strategies.

Provisions in respect of credit losses charged to income in 2002 reduced by \$3.2 million, to \$2.2 million, reflecting the underlying quality of our loan portfolio.

Non-interest income grew to \$126.3 million (including \$17.0 million from the sale of a controlling interest in our Hong Kong subsidiaries) compared to \$91.8 million last year, an underlying growth rate of 19.1% when excluding the Hong Kong sale proceeds. This reflects the Group's continued efforts to raise non-interest revenue, as a percentage of total income. Significant growth was seen in the areas of corporate services, up 32.8%, trust and executorship fees, up 49.6%, foreign exchange, up 15.7% and banking related fees, up 12.6%.

Income from fees and other non-interest sources now accounts for 52.9% of our total income (excluding the Hong Kong sale proceeds) compared to 47.8% per cent last year. This income is particularly important, given that it does not require significant amounts of regulatory capital support.



## Fee Income

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

	2002	2001	% Change
Fees, commissions and service charges	31,521	28,006	12.6 %
Trust and executorship fees	21,590	14,428	49.6 %
Investment services revenue	19,301	18,797	2.7 %
Corporate services revenue	16,884	12,716	32.8 %
Foreign exchange revenue	16,273	14,066	15.7 %
Other income	3,753	3,762	-0.2 %
<b>Total Fee Income</b>	<b>109,322</b>	<b>91,775</b>	<b>19.1 %</b>

## Changes in Net Interest Income

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

	2002			2001		
	Average Balance	Interest	Rate	Average Balance	Interest	Rate
<b>Assets</b>						
Cash and deposits with banks	1,944,945	55,350	2.8%	1,534,191	89,632	5.8%
Investments	1,797,464	57,925	3.2%	1,870,551	113,323	6.1%
Loans	1,594,179	101,168	6.3%	1,357,534	107,524	7.9%
Earning assets	5,336,588	214,443	4.0%	4,762,276	310,479	6.5%
Other assets	166,173	-	-	171,400	-	-
<b>Total Assets</b>	<b>5,502,761</b>	<b>214,443</b>	<b>3.9%</b>	<b>4,933,676</b>	<b>310,479</b>	<b>6.3%</b>
<b>Liabilities</b>						
Deposits	4,536,221	113,627	2.5%	4,022,271	201,195	5.0%
Repurchase agreements	39,901	941	2.4%	70,912	3,668	5.2%
Subordinated debt	75,000	2,638	3.5%	75,000	5,403	7.2%
Interest bearing liabilities	4,651,122	117,206	2.5%	4,168,183	210,266	5.0%
Non interest bearing current accounts	466,262	-	-	420,796	-	-
Other liabilities	81,569	-	-	76,639	-	-
<b>Total Liabilities</b>	<b>5,198,953</b>	<b>117,206</b>	<b>2.3%</b>	<b>4,665,618</b>	<b>210,266</b>	<b>4.5%</b>
<b>Shareholders' Equity</b>	<b>303,808</b>	-	-	<b>268,058</b>	-	-
<b>Total Liabilities and Shareholders' Equity</b>	<b>5,502,761</b>			<b>4,933,676</b>		
<b>Spread</b>			<b>1.5%</b>			<b>1.5%</b>
<b>Net Interest Margin</b>			<b>1.8%</b>			<b>2.1%</b>

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



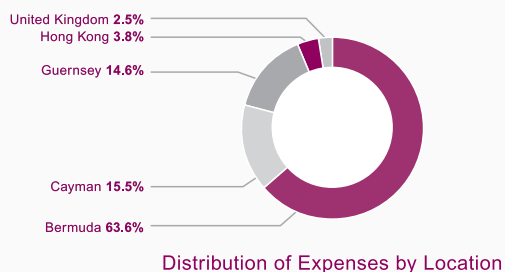
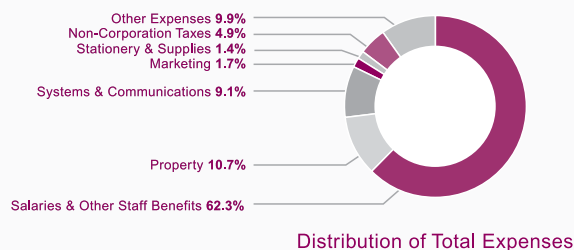
## Expenses

Expenses excluding corporation tax were \$142.2 million during the year under review, an increase of \$17.4 million, or 14.0%, from \$124.8 million in 2001. The main reason for this increase relates to the higher cost base of our Guernsey operation following the acquisition in July 2001 of CIBC's business in that jurisdiction. In addition, it will be recalled that there was a one-time credit in 2001 in respect of the pension plan of \$2.8 million, which compares to a debit of \$1.1 million in 2002. We remain committed to the prudent management of our expense base and continually seek opportunities for efficiency improvement.

A large share of the expense was associated with our Bermuda-based operations. However, this reduced from 71.0% of total Group expenses last year to 63.6%.

At the close of the financial year we had 1,229 employees, up from 1,162 last year primarily due to the acquisition in Guernsey, where the number of employees increased by 123. We added four employees in each of our United Kingdom and Cayman Islands locations, and five in Bermuda. The sale of a controlling interest in our Hong Kong subsidiaries reduced the Group employee base by 69.

Salaries and employee benefits increased by 23.1% to \$88.6 million, reflecting the increased headcount, and now account for 62.3% of total Group expenses, compared to 57.7% a year ago. Non employee related expenses, however, only increased by 1.6%, or \$0.8 million, to \$53.6 million, reflecting lower systems related costs and expense control.



## Assets

Total assets increased by 10.4% to \$5.7 billion, from \$5.2 billion a year ago, which reflects the acquisition of the CIBC businesses in Guernsey and increased balance sheet growth in both Bermuda (up \$100.7 million) and the Cayman Islands (up \$144.1 million). The Group's average interest earning assets increased by \$574.3 million, or 12.1%, as a result.

The Group's loan to assets ratio increased slightly, from 27.9% a year ago to 29.6%.



## Liabilities

The Group's customer deposit base increased during the year under review, up \$322.8 million, or 7.2%, to \$4.8 billion due mainly to the acquisition of the CIBC businesses in Guernsey and a \$100.0 million increase in customer deposits in Cayman. The customer deposit base remains highly stable. Term deposits represent 60.7% of customer deposits, compared to 59.8% a year ago, and we have successfully attracted new deposits to the Group in Bermuda and the Cayman Islands.

Deposits from banks and repurchase agreements rose \$167.6 million, or 57.5%, to \$459.3 million reflecting the increased money market activities of our Bermuda based Treasury business.

## Taxes

In 2002 we obtained corporation tax credits in respect of the amalgamations of the ANZ Guernsey and CIBC Guernsey acquisitions. This resulted in a net corporation tax credit of \$88,000 for our Guernsey business, offset by an expense of \$70,000 in respect of the UK business. We also paid \$6.9 million in non profits taxes across the Group, up from \$5.8 million in 2001. This was made up of \$6.0 million in Bermuda, \$0.6 million in Cayman, \$0.1 million in Hong Kong and \$0.2 million in the UK. Although the Governments of Bermuda and Cayman do not collect profits tax, they maintain efficient and appropriate taxation systems, based on consumption, to finance normal Government activities. Both the Bermuda and the Cayman Islands authorities increased bank licence fees during the year under review.

## Discontinued Operations

During 2001 the portfolio of loans from discontinued operations was written off at a net loss of \$6.0 million. During 2002 we were able to achieve some modest recoveries in respect of our former businesses, which resulted in net income from discontinued operations of \$0.9 million. We do not anticipate any significant further recoveries in respect of those former businesses.

## Capital Composition

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

	2002	2001
Tier 1 Capital	307,052	278,742
Tier 2 Capital	95,585	95,576
<b>Total Capital</b>	<b>402,637</b>	<b>374,318</b>

## Risk Weighted Assets

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

Cash and inter-bank placements	402,853	348,131
Investments	712,803	728,483
Loans	1,216,768	1,020,236
Other assets	154,942	157,614
Off-balance sheet items	425,131	280,610
<b>Total Risk Weighted Assets</b>	<b>2,912,497</b>	<b>2,535,074</b>

## Capital Ratios

Tier 1	10.5%	11.0%
Tier 2	3.3%	3.8%
<b>Total</b>	<b>13.8%</b>	<b>14.8%</b>



## Capital and Liquidity

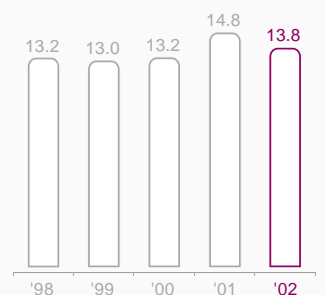
The Group maintains a strong capital base that ensures stability and allows us to take advantage of opportunities for growth. At 30 June 2002, the risk weighted total capital ratio was 13.8%, with Tier 1 capital at 10.5% and Tier 2 capital at 3.3%. This compares with last year's ratios of 14.8%, 11.0% and 3.8% respectively.

The reduction reflects the strong growth in higher risk weighted loan assets and the increased loan to the Stock Option Trust (up \$8.6 million to \$40.0 million) in respect of potential obligations under the Bank's Stock Option Plan, which is deducted from shareholders' equity. Risk weighted assets increased by 14.9% to \$2.9 billion, primarily due to loan growth in Bermuda coupled with the CIBC Guernsey acquisition.

Retained earnings, after dividends declared of \$24.7 million, were \$57.6 million for the year, up from \$40.2 million a year ago. In August 2001 the Bank declared a 1 for 10 stock dividend, which increased the shares in issue by 1.9 million. This resulted in a \$64.8 million reduction in retained earnings and an offsetting increase in share capital (\$1.9 million) and share premium (\$62.9 million). Shareholders' equity increased by \$48.6 million, or 17.0% over last year.

During the course of the year the Bank issued 219,431 shares (2001: 222,230 shares) under the Dividend Re-investment Programme, which represent a cash saving of \$7.0 million, or 28.5% of the total dividend declared. Under the Share Buy-Back Plan, the Bank purchased 287,521 shares (2001: 420,637) at a cost of \$9.1 million (2001: \$8.6 million) as part of our strategy to enhance shareholder value.

The balance sheet remains highly liquid with some 67.2% of assets either employed in deposits with high quality international banks (\$2.0 billion) or in investments (\$1.8 billion).



Risk Weighted Total Capital Ratio (%)

## 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 conduct 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 operational risks.



## Credit Risk

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

Total loans at 30 June 2002 amounted to \$1.7 billion, up from \$1.5 billion a year ago. This reflects quality loan growth across the Group's core businesses. Loans now represent 29.6% of total assets, up from 27.9% last year. Consistent with the economic environment in the tourist-related economies of Bermuda and the Cayman Islands post 11 September 2001, the Group's non-accrual loans increased from \$9.5 million a year ago to \$24.8 million. (See also comments in Overview of Performance on Page 15).

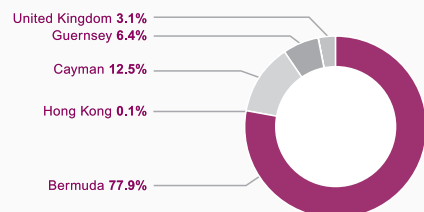
Our prudent approach to provisions continued with our general loan provision set at \$20.6 million, in line with a year ago. This represents 1.2% of the total loan portfolio. Specific provisions total \$3.9 million, compared to \$4.2 million a year ago.

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.

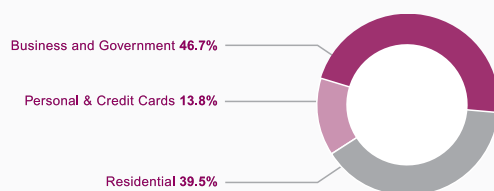
The Credit Risk Management department and the Credit Committee, which is chaired by the President & CEO, has responsibility for the policies, mechanisms, organisation and procedures required to analyse, manage and control credit risk. The Group's Credit Committee, Risk Policy Committee and Board of Directors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

Loans in Bermuda remain the largest portion of the Group's lending, at 77.9% of the total portfolio. Some 52.6% of the portfolio consists of personal lending, through domestic mortgages, consumer and education loans, with the remainder in local corporate lending.

Residential mortgage lending in Bermuda at 30 June 2002 was \$529.4 million, up 8.2% from \$489.5 million in 2001. Lending by our businesses outside Bermuda was up 13.0% to \$379.7 million, with the principal growth seen in Cayman (up 12.4%) and Guernsey (up 19.1%), the latter reflecting the CIBC Guernsey acquisition.



Lending by Location



Bermuda Loans by Type



## 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, middle and back office duties are segregated and limits reviewed and approved.

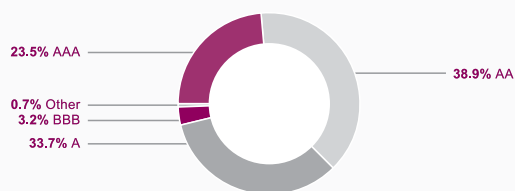
We use Value at Risk (VAR) methodology for management and daily monitoring of risks related to trading activities. The Asset and Liability Management Committee (ALCO) plays an integral role in identifying, reviewing and managing key financial strategic exposures. Its emphasis is on controlling risk while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

## Investment Portfolios

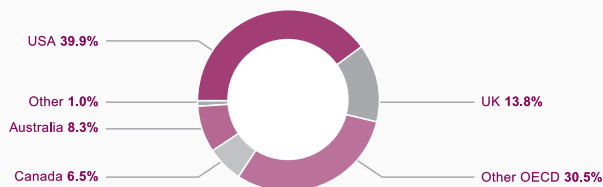
The Bank has engaged Standard & Poor's, the world renowned credit rating agency, to monitor and rate the Bank's own securities portfolios, which constitute some 91.5% of the Bank's total investments. All of these portfolios have received investment grade ratings, as highlighted in the table below.

### Summary of Group's Debt Securities Monitored and Rated by Standard & Poor's as at 30 June 2002

Portfolio	Location	Carrying Value (\$m)	% of Total Investments Rated by S&P	S&P Credit Rating	S&P Volatility Rating
Fixed Income	Bermuda	190.3	11.5	AAf	S1
Floating Rate Notes	Bermuda	1094.7	65.3	Af	S1
Floating Rate Notes	Cayman	234.3	14.0	Af	S1
Floating Rate Notes	Guernsey	156.0	9.2	Af	S1



Investment Portfolio by Long Term Debt Rating



Investment Portfolio by Country of Issuer



The average yield on our investments in 2002 was 3.2%, down from 6.1% in 2001 as a result of the decline in US interest rates. The portfolio primarily consists of floating rate notes. As at 30 June 2002 the S&P rated portfolios totalled \$1.7 billion or 91.7% of total investments. A decision was made by ALCO to sell the Group's holdings of US corporate and asset backed securities due to credit concerns post 11 September 2001. As a result securities with a nominal book value of \$150.9 million were sold and a net loss of \$1.2 million was realised.

### 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 to ALCO approved trading limits, 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.

As at 30 June 2002 the Group's cumulative interest rate sensitivity gap out to 12 months was \$248 million, down from \$421 million a year ago, reflecting increased usage of interest rate swaps as part of the Group's asset/liability management strategy to enhance interest income in the current low US interest rate environment.

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 ALCO. Transaction exposure is managed as part of daily trading positions under foreign exchange limits unless a special situation exists for which ALCO 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 and London, 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 accordingly to ALCO 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 credit ratings that enable 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 ALCO.



### Derivative Products

Derivatives are used as 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 operational risk (see note 13 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.

As at 30 June 2002 the Group had entered into interest rate swaps with a notional principal amount of \$432.5 million for asset/liability management purposes, up from \$96.8 million the previous year, principally to enhance yield on surplus liquidity. These transactions had a net positive mark to market value of \$5.0 million and an average duration of 2.6 years at 30 June 2002. As non-trading positions, income and expense is recognised over the life of the related position as an adjustment to net interest income.

### 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. There are no outstanding actions or legal proceedings pending which in management's opinion are material to the consolidated financial position of the Bank.

### Operational Risk

Operational 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 reports directly to the senior officer in each jurisdiction in which we do business. In Guernsey and the United Kingdom the internal audit function has been out-sourced to one of the leading accounting firms. In each operation, including Bermuda and the Cayman Islands, the Head of Internal Audit has direct access to the Board of Directors.

A Risk Review Committee has been established to monitor operational risk and compliance, ensuring appropriate internal controls and corporate governance. This Committee, chaired by the Chief Financial Officer, reviews and monitors business/event risks, insurance coverage, transactions and operational controls, operating losses and frauds, business continuity, potential regulatory changes, legal risks and compliance with financial and business conduct regulations. The Board's Audit and Compliance Committee also reviews internal audit, compliance and litigation reports.

### 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.

As our Internet banking and e-commerce activities continue to increase and evolve, we monitor and manage the related risks, such as information security, privacy and business continuity.

The Bank's Technology Committee, chaired by the Chief Executive Officer, directs the strategy for information technology management, including risk and related policies and practices.

