1 Significant Accounting Policies

These consolidated financial statements are prepared in accordance with accounting principles generally accepted in Bermuda and Canada. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements. Estimates also affect the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates. The following is a summary of those accounting policies considered to be significant:

(a) Basis of Consolidation: The consolidated financial statements include the assets, liabilities and results of operations of the Bank and all of its subsidiaries. Subsidiaries are companies which the Bank controls and are normally those in which the Bank owns directly or indirectly more than 50% of the voting shares. The purchase method is used to account for all business acquisitions. The difference between the acquisition cost of an investment and the fair value of the net assets acquired represents goodwill which is amortised to income over a period not to exceed 20 years.

The Bank's interest in its joint venture is recognised using the proportionate consolidation method. Under this approach the Bank's share of the joint venture's assets, liabilities, revenues and expenses is reported on a line-by-line basis.

(b) Translation of Foreign Currencies: Assets and liabilities denominated in foreign currencies are translated into Bermuda dollars at the rates of exchange prevailing at the balance sheet date.

All revenues and expenses denominated in foreign currencies are translated into Bermuda dollars at the average rates of exchange prevailing throughout the year. Resulting gains or losses are included as foreign exchange income in the Consolidated Statement of Income.

(c) Investments: Investment portfolio securities are securities where the Bank's original intention is to hold to maturity. They are carried at cost or amortised cost, adjusted to recognise other than temporary impairment in the underlying value, except for money market mutual funds which are carried at market value which approximates amortised cost. Investments held in the trading portfolio are carried at market value and any adjustments to market value of these investments are included in the Consolidated Statement of Income.

(d) Loans: Loans are stated net of unearned income and an allowance for credit losses. A loan is classified as non-accrual when, in the opinion of management, there is reasonable doubt as to the ultimate collectability of a portion of principal or interest. A loan is also classified as non-accrual when interest is contractually 90 days past due, unless there is no reasonable doubt as to the collectability of both principal and interest. When a loan is classified as non-accrual, accrued but uncollected interest is reversed against income. Thereafter, interest income is recognised on a cash basis only after specific provisions for losses have been recovered and provided there is no further doubt as to the collectability of principal. Non-accrual loans may revert to performing status when all payments become fully up-to-date and, in the opinion of management, there is no reasonable doubt as to the ultimate collectability of the principal or interest.

All non-accrual loans are considered to be impaired loans. The allowance for credit losses for all significant impaired loans is determined by discounting the estimated future cash flows using the inherent interest rate or the fair value of collateral for certain collateral dependent loans. The allowance for credit losses for all other impaired loans is based on management's best estimate of future losses arising from these loans. The adequacy of the reserve is reviewed regularly by management taking into consideration matters such as current economic conditions, past loss experience, known and inherent risks in the portfolio, adverse circumstances that may affect a borrower's ability to pay and other relevant factors. This evaluation is inherently subjective, as it requires material estimates including the amount and timing of future cash flows expected to be received on impaired loans which may be susceptible to significant change.

A general provision for credit losses is established, based on prudent management estimation, in respect of loans for which individual specific provisions cannot yet be determined.

(e) Premises and Equipment: Land is carried at cost. Premises, equipment and leasehold improvements are carried at cost less accumulated depreciation and/or amortisation. Depreciation and amortisation are calculated using the straight-line method over the estimated useful lives of the related assets, which are up to 50 years for buildings, up to 10 years for furniture, up to 5 years for computers and equipment and, in the case of leasehold improvements, the term of the lease.

(f) Retirement Plans: The Bank maintains a non-contributory defined benefit pension plan for substantially all employees, except those in Cayman. Benefits are primarily based on the employee's years of credited service and average annual salary as defined in the plan. Annual changes in net pension assets or obligations arising from experience gains or losses, changes in assumptions, and plan amendments, and the net pension asset at the date the policy was implemented, are amortised on a straight-line basis over the expected average remaining service life of the employees covered by the plan, which in 2000 was fourteen years. The cumulative difference between pension expense and the funding contributions is reported in other assets.

The Bank provides post-retirement medical benefits for substantially all retired employees. Effective 1 July 1997, the Bank retroactively adopted the accrual basis of accounting for these benefits whereby an accrual is made for the present value of the future benefits to be provided, in the reporting period in which the employee has provided the related service. Annual changes in the post-retirement medical benefit obligation arising from actuarial gains and losses, changes in assumptions and plan amendments are amortised on a straight-line basis over the expected average remaining service life to full eligibility age of employees covered by the plan, which in 2000 is thirteen years.

(g) Derivatives: Derivatives are used for asset and liability management and proprietary trading purposes and also to provide clients with the ability to manage their own market risk exposures. The most frequently used derivative products are foreign exchange contracts and interest rate swaps.

Asset and liability management derivatives are used to manage the Bank's own exposure to interest rate and foreign exchange risks which arise from the Bank's balance sheet positions. Realised gains or losses on these derivatives are deferred and amortised over the remaining life of the related positions. The amortised gains or losses are included in interest income. Unrealised gains and losses are not recognised.

Proprietary trading derivatives are marked to market and realised and unrealised gains and losses are included in interest income.

(h) Securities Sold Under Agreements to Repurchase: Securities sold under agreements to repurchase arise on the sale of a security with the commitment by the Bank to repurchase the security at a specified price and are carried at cost on the Consolidated Balance Sheet. The difference between the sale price and the agreed repurchase price is recorded as an interest expense.

(i) Loan to Stock Option Trust: The loan made to finance the acquisition of shares by the Stock Option Trust is shown as a deduction from shareholders' equity, and dividends paid on the acquired shares are deducted in arriving at dividends paid reflected in the Statements of Changes in Shareholders' Equity and Cash Flows. The weighted average number of shares outstanding used in the calculation of earnings per share is calculated after deducting the shares held by the Stock Option Trust during the year.

(j) Net Income Per Share: Net income per share has been calculated using the weighted average number of shares outstanding during the year as described in 1(i) above. Fully diluted net income per share, calculated after giving effect to the potential dilution arising from the existence of stock options, is not materially different from the net income per share disclosed in the Consolidated Statement of Income.

2 Cash and Deposits with Banks

A summary of cash and deposits with banks as at 30 June follows:

(In $ thousands)	2000	1999
Cash and demand deposits	**63,697**	17,175
Term deposits maturing within six months	**1,305,230**	1,354,033
Term deposits maturing within six to twelve months	**145,886**	50,634
Total	**1,514,813**	1,421,842

3 Investments

(a) Maturity: A summary of investments as at 30 June follows:

30 June 2000 (In $ thousands)	Within 1 Year	1 To 3 Years	3 To 5 Years	5 To 10 Years	Over 10 Years*	Total
Marketable Securities						
US Government	–	50,000	–	10,023	9,013	69,036
Other OECD Governments	14,021	22,579	–	100	–	36,700
Financial institution debt	224,490	716,369	301,351	2,400	–	1,244,610
Corporate and asset backed debt	34,540	156,991	142,545	42,612	68,217	444,905
Non OECD Governments	–	–	–	13,283	–	13,283
Mutual fund/ equity investments	–	–	–	–	22,769	22,769
Total	**273,051**	**945,939**	**443,896**	**68,418**	**99,999**	**1,831,303**

30 June 1999 (In $ thousands)	Within 1 Year	1 To 3 Years	3 To 5 Years	5 To 10 Years	Over 10 Years*	Total
Marketable Securities						
US Government	–	32,443	56,632	2,500	2,000	93,575
Other OECD Governments	194,821	30,687	–	–	–	225,508
Financial institution debt	152,468	512,462	241,693	4,995	–	911,618
Corporate and asset backed debt	98,015	156,515	143,010	38,333	–	435,873
Mutual fund/ equity investments	–	–	–	–	39,279	39,279
Total	445,304	732,107	441,335	45,828	41,279	1,705,853

* Instruments with no specific maturity date are listed as Over 10 years.

All of the above amounts are held in the investment portfolio and are carried at amortised cost with the exception of the trading portfolio which amounts to $14,270 ($27,317 in 1999), and is carried at market value. Actual maturities may differ from the stated maturities reflected above because certain investments may have call or prepayment features.

(b) Market Value Summary

(In $ thousands)	30 June 2000			30 June 1999		
	Carrying Value	**Unrealised Gain/(Loss)**	**Market Value**	Carrying Value	Unrealised Gain/(Loss)	Market Value
Marketable Securities						
US Government	69,036	(635)	68,401	93,575	(2,755)	90,820
Other OECD Governments	36,700	(9)	36,691	225,508	(1,151)	224,357
Financial institution debt	1,244,610	(6,288)	1,238,322	911,618	(1,132)	910,486
Corporate and asset backed debt	444,905	(9,949)	434,956	435,873	(3,079)	432,794
Non OECD Governments	13,283	214	13,497	–	–	–
Mutual fund/ equity investments	22,769	(40)	22,729	39,279	5	39,284
Total	**1,831,303**	**(16,707)**	**1,814,596**	1,705,853	(8,112)	1,697,741

Marketable Securities, excluding mutual funds/equity investments include $478,441 ($419,025 in 1999) of fixed rate instruments and $1,330,093 ($1,247,549 in 1999) of floating rate instruments. The approximate yield on the floating rate securities as at 30 June 2000 was 6.70% (5.24% in 1999), while the approximate yield on the fixed rate securities was 6.33% (6.38% in 1999). Unrealised gains were $628 ($387 in 1999) and unrealised losses were $17,335 ($8,499 in 1999).

4 Loans

An analysis of loans, net of allowance for credit losses, as at 30 June follows:

(In $ thousands)	2000	1999
Mortgages	614,144	551,950
Personal, commercial and other loans	670,079	671,209
Total	**1,284,223**	1,223,159

The split of the mortgage book between Bermuda and overseas is as follows:

(In $ thousands)	2000	1999
Bermuda	492,170	455,642
Overseas	121,974	96,308
Total	614,144	551,950

The split of the personal, commercial and other loan portfolios is as follows:

(In $ thousands)	2000	1999
Bermuda	546,911	518,144
Overseas	123,168	153,065
Total	670,079	671,209

The principal means of securing personal, commercial and other loans are charges over assets and guarantees. Mortgage loans are generally repayable over fifteen years and personal, commercial and other loans are generally repayable over terms not exceeding five years. The effective yield on total loans as at 30 June 2000 is 8.8% (8% in 1999).

At 30 June 2000 the Bank had non-accrual loans amounting to $18,781 ($52,108 in 1999) and an allowance for credit losses of $22,350 ($34,623 in 1999). The allowance for credit losses is deducted in arriving at the net loan figure shown in the Consolidated Balance Sheet.

The movement in the allowance for credit losses during the year was as follows:

(In $ thousands)	2000	1999
Balance at Beginning of Year	34,623	37,611
Provision for credit losses	18,656	15,328
Loans written off	(30,929)	(18,316)
Balance at End of Year	22,350	34,623
This is represented by:		
Specific provisions	5,763	20,744
General provisions	16,587	13,879
Total	22,350	34,623

An analysis of loans, net of the allowance for credit losses, by geographical location of the Bank's operation as at 30 June follows:

(In $ thousands)	2000	1999
Bermuda	1,039,081	973,786
United Kingdom	–	64,034
Guernsey	86,153	55,445
Cayman	158,812	129,292
Hong Kong	177	602
Total	1,284,223	1,223,159

5 Premises and Equipment

A summary of premises and equipment as at 30 June follows:

(In $ thousands)	Cost	Accumulated Depreciation & Amortisation	Net Book Value 2000	Net Book Value 1999
Land	10,885	–	10,885	9,127
Buildings	76,368	15,602	60,766	51,153
Equipment	70,290	45,384	24,906	30,153
Total	157,543	60,986	96,557	90,433

Depreciation and amortisation charged to operating expenses for the year ended 30 June 2000 was $11,476 ($10,527 in 1999).

6 Pension Plan

There is a trusteed, non-contributory pension plan covering substantially all employees of the Bank and its subsidiaries, except Cayman.

The market value of pension plan assets as at 30 June 2000 was $76,033 ($69,759 in 1999), and the present value of accrued pension benefits attributable to services rendered up to that date was $67,366 ($62,217 in 1999). Actuarial valuations of the plan are made every two years; the most recent of which was as at 30 June 1998.

Total pension expense recorded for the year was $2,748 ($2,627 in 1999) and is charged to operating expenses. The cumulative difference between the funding contributions and pension expense has been reflected in Other Assets in the Consolidated Balance Sheet as a deferred charge of $2,607 as at 30 June 2000 ($2,244 in 1999).

7 Deposits

An analysis of deposits as at 30 June follows:

(In $ thousands)	2000	1999
Demand	**1,559,272**	1,294,963
Term deposits maturing within six months	**2,423,036**	2,298,100
Term deposits maturing within six to twelve months	**117,592**	89,774
Term deposits maturing after twelve months	**237,882**	218,314
Total	**4,337,782**	3,901,151

The effective yield on deposits as at 30 June 2000 is 4.3% (4.4% at 30 June 1999).

8 Assets Under Administration

Securities and properties (other than cash deposits directly with the Bank and its subsidiaries) held in a trust, agency or fiduciary capacity for customers, including mutual funds, are not included in the Consolidated Balance Sheet as they are not the property of the Bank or its subsidiaries. The value of assets under administration as at 30 June 2000 was estimated to be $34.10 billion ($30.75 billion in 1999).

9 Contingent Liabilities and Commitments

The Bank was contingently liable for letters of credit, guarantees, and other contracts amounting to $447,986 as at 30 June 2000 ($424,565 in 1999) of which $408,107 was fully collateralised ($344,031 in 1999).

The Bank's commitment for undrawn lines of credit amounted to $321,908 as at 30 June 2000 ($152,496 in 1999).

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

10 Segmented Information

a) Operating Segments: The Bank has adopted the accounting requirements relating to the presentation of operating segments based upon its internal management reporting structure. Management has identified its reportable segments based upon the geographic location of the Bank's operations except that Bermuda is further subdivided based on products and services into Community Banking, including Treasury operations, Asset Management and Real Estate and the Bank's proportionate share of the assets, liabilities, income and expenses of its joint venture, ProServe Bermuda Limited. Accounting policies of the reportable segments are the same as those described in note 1.The following changes of note occurred during the period under review:

i) On 7 January 2000 ANZ Bank (Guernsey) Limited and ANZ Nominees (Guernsey) Limited were acquired by the Bank's Guernsey subsidiary, Bank of Butterfield International (Guernsey) Limited. The companies had assets of $419.6 million and liabilities of $388.4 million at the time of acquisition and were acquired for a cash consideration of $39.4 million, with the resultant goodwill of $8.2 million being amortised over 15 years.

ii) On 16 June 2000 the Bank sold Davenham Group Plc at a small premium over book value. Accordingly, the United Kingdom results for the year include income up to the date of sale.

Operating segment information follows:

Total Assets (In $ thousands)	**2000**	1999
Community Banking	**2,909,892**	3,043,289
Asset Management	**34,856**	45,162
Real Estate	**54,993**	47,610
Total Bermuda	**2,999,741**	3,136,061
Cayman	**955,182**	827,797
Guernsey	**690,907**	376,696
United Kingdom	**–**	58,370
Hong Kong	**126,252**	79,257
Total Overseas	**1,772,341**	1,342,120
Total Continuing Operations	**4,772,082**	4,478,181
Discontinued Operations	**21,930**	34,362
Total	**4,794,012**	4,512,543

Business Area Analysis 2000 (In $ thousands)	**Net Interest Income Customer**	**Net Interest Income Intersegment**	**Fees and Other Income**	**Total Income**	**Other Expenses**	**Amortisation of Capital Assets**	**Total Expenses**	**Net Income**
Community Banking	**63,779**	**(488)**	**27,447**	**90,738**	**65,214**	**6,931**	**72,145**	**18,593**
Asset Management	**2,963**	**239**	**28,399**	**31,601**	**22,962**	**533**	**23,495**	**8,106**
Real Estate	**–**	**(651)**	**8,448**	**7,797**	**4,309**	**2,011**	**6,320**	**1,477**
Total Bermuda	**66,742**	**(900)**	**64,294**	**130,136**	**92,485**	**9,475**	**101,960**	**28,176**
Cayman	**19,195**	**1,380**	**17,407**	**37,982**	**15,178**	**1,445**	**16,623**	**21,359**
Guernsey	**2,672**	**1,869**	**6,901**	**11,442**	**8,106**	**402**	**8,508**	**2,934**
United Kingdom	**8,340**	**(2,521)**	**496**	**6,315**	**4,073**	**229**	**4,302**	**2,013**
Hong Kong	**538**	**172**	**4,700**	**5,410**	**4,827**	**178**	**5,005**	**405**
Total Overseas	**30,745**	**900**	**29,504**	**61,149**	**32,184**	**2,254**	**34,438**	**26,711**
Gross Total	**97,487**	**–**	**93,798**	**191,285**	**124,669**	**11,729**	**136,398**	**54,887**
Less: Intersegment eliminations, principally rent and management fees	**–**	**–**	**(10,430)**	**(10,430)**	**(10,430)**	**–**	**(10,430)**	**–**
Total Before Discontinued Operations	**97,487**	**–**	**83,368**	**180,855**	**114,239**	**11,729**	**125,968**	**54,887**
Discontinued Operations	**(14,540)**	**–**	**–**	**(14,540)**	**–**	**–**	**–**	**(14,540)**
Total After Discontinued Operations	**82,947**	**–**	**83,368**	**166,315**	**114,239**	**11,729**	**125,968**	**40,347**

Business Area Analysis 1999 (In $ thousands)								
Community Banking	44,992	(1,246)	27,952	71,698	56,465	6,612	63,077	8,621
Asset Management	3,217	(708)	25,594	28,103	21,521	543	22,064	6,039
Real Estate	–	(458)	7,328	6,870	3,337	2,017	5,354	1,516
Total Bermuda	48,209	(2,412)	60,874	106,671	81,323	9,172	90,495	16,176
Cayman	13,380	3,112	13,331	29,823	12,663	1,119	13,782	16,041
Guernsey	1,286	1,872	5,912	9,070	6,349	382	6,731	2,339
United Kingdom	5,429	(2,379)	3,312	6,362	4,159	247	4,406	1,956
Hong Kong	1,223	(193)	4,041	5,071	5,022	153	5,175	(104)
Total Overseas	21,318	2,412	26,596	50,326	28,193	1,901	30,094	20,232
Gross Total	69,527	–	87,470	156,997	109,516	11,073	120,589	36,408
Less: Intersegment eliminations, principally rent and management fees	–	–	(7,420)	(7,420)	(6,874)	(546)	(7,420)	–
Total	69,527	–	80,050	149,577	102,642	10,527	113,169	36,408

Included within interest paid, other income and other expenses for Bermuda in 2000 are certain charges aggregating $1,527 relating to the internal reconciliation process, and included within other expenses for Guernsey and UK is income tax expense of $781 ($589 in 1999) and $1,076 ($982 in 1999), respectively. Transactions between operating segments principally include interbank deposits and rent which are recorded based upon market rates and management fees, which are recorded based on the cost of the services provided.

(b) Revenues by Products and Services: The principal sources of total interest income are deposits with banks, loans to customers and investments, and are disclosed separately in the Statement of Income. Fee income by products and services is as follows:

(In $ thousands)	2000	1999
Fees, commissions and service charges	25,028	28,857
Trust and executorship fees	15,216	12,850
Investment services revenues, including brokerage	16,403	14,023
Corporate administration and finance	10,526	9,136
Foreign exchange revenue	13,133	11,988
Other income	3,062	3,196
Total Fee Income	**83,368**	80,050

Fees, commissions and service charges comprise principally fees from loans and other banking transactions.

11 Derivative Financial Instruments

(a) Notional Amounts: The following table provides the aggregate notional amounts of derivative contracts outstanding at 30 June listed by type and divided between those used for trading and those used in managing the Bank's asset and liability risk management (ALM) exposures. The notional principal amounts of these contracts do not represent the potential gain or loss associated with the positions, but rather the amount to which a rate or price is applied to determine the amount of cash flows to be exchanged.

	30 June 2000			30 June 1999		
(In $ thousands)	Trading	ALM	Total Value	Trading	ALM	Total Value
Interest Rate Contracts						
Over-the-Counter Traded						
Interest rate swaps	–	90,373	90,373	–	334,792	334,792
Total	–	90,373	90,373	–	334,792	334,792
Foreign Exchange Contracts						
Spot and forwards	36,431	173,135	209,566	110,130	92,179	202,309
Total	36,431	173,135	209,566	110,130	92,179	202,309
Total Notional Financial Derivatives Outstanding	36,431	263,508	299,939	110,130	426,971	537,101

(b) Fair Value: The following table shows the mark to market fair value of all derivative contracts outstanding as at 30 June. This is defined as the profit (loss) associated with replacing the derivative contracts at prevailing market prices.

	30 June 2000			30 June 1999		
(In $ thousands)	Positive	Negative	Net	Positive	Negative	Net
Derivative Financial Instruments						
Interest rate swaps	1,697	829	868	2,061	1,145	916
Spot and forward foreign exchange	921	189	732	1,187	8	1,179

(c) Remaining Maturity: The following table summarises the remaining term maturity of the notional amounts of the Bank's derivative instruments by type:

30 June 2000 (In $ thousands)	0-6 mths	6-12 mths	1-3 years	3-5 years	5-10 years	Total
Interest Rate Contracts						
Interest rate swaps	22,699	–	45,250	8,924	13,500	90,373
Total	22,699	–	45,250	8,924	13,500	90,373
Foreign Exchange Contracts						
Spot and forwards	208,360	1,206	–	–	–	209,566
Total	208,360	1,206	–	–	–	209,566
Total by Remaining Maturity	231,059	1,206	45,250	8,924	13,500	299,939
30 June 1999 (In $ thousands)						
Interest Rate Contracts						
Interest rate swaps	138,094	135,606	42,093	18,999	–	334,792
Total	138,094	135,606	42,093	18,999	–	334,792
Foreign Exchange Contracts						
Spot and forwards	202,309	–	–	–	–	202,309
Total	202,309	–	–	–	–	202,309
Total by Remaining Maturity	340,403	135,606	42,093	18,999	–	537,101

(d) Replacement: The following table reflects the replacement cost of all derivative contracts outstanding as at 30 June. This is defined as the cost of replacing, at current market rates, all contracts which have a positive fair value (unrealised gains) and amounts receivable on derivative contracts.

	30 June 2000			30 June 1999		
(In $ thousands)	Trading	ALM	Total Value	Trading	ALM	Total Value
Interest Rate Contracts						
Interest rate swaps	–	1,697	1,697	–	2,061	2,061
Total	–	1,697	1,697	–	2,061	2,061
Foreign Exchange Contracts						
Spot and forwards	14	907	921	271	916	1,187
Total	14	907	921	271	916	1,187
Total Replacement Cost	14	2,604	2,618	271	2,977	3,248

Net realised losses on derivative contracts designated as hedges during 2000 were $562 ($1,978 gain in 1999). Interest income for the year ended 30 June 2000 also included net amortised losses of $45 from hedging activity (amortised losses of $293 from hedging activity in 1999).

The Bank uses various off-balance sheet derivative contracts in the management of its assets and liability positions, for trading purposes and as a market maker for its clients' needs. The Bank enters into foreign exchange contracts as a market maker, for asset and liability management and to facilitate the needs of its customers. Interest rate contracts are used for trading and asset and liability management purposes. These contracts are financial instruments, the value of which is derived from underlying assets or interest and exchange rates. Such financial instruments used by the Bank include:

Interest rate swaps are transactions in which two counterparties exchange interest payments based on a specified notional principal amount for a predetermined period, based on agreed-upon fixed and floating rates. Notional amounts are not exchanged.

Cross currency interest rate swaps are transactions in which two counterparties exchange currencies and interest rates on a specified notional amount for a predetermined period. The notional amount is generally exchanged at inception and re-exchanged at maturity. Cross currency interest rate swaps are transactions in which interest payments in one currency are exchanged for interest payments in another.

Foreign exchange forwards are contracts to exchange two currencies based on a rate agreed to by both parties at inception for settlement at a predetermined future date. Spot transactions are similar to forward contracts except that settlement takes place within two business days. The Bank enters into these contracts to service the needs of its customers, as a market maker and to manage its own asset/liability exposures.

By entering into these financial instruments the Bank incurs credit and/or market risk. Credit risk is the risk that, due to adverse business conditions, a counterparty may be unable to perform on its obligations prior to their maturity and is limited to the replacement cost of the derivative at the date the counterparty fails to perform its obligation. Credit risk is minimised by Bank policy that stipulates that contractual obligations are limited to only strong financial institutions. Market risk is the risk that fluctuations in asset and currency markets may cause adverse price movements in the fair value of the underlying contracts. Market risk is managed within clearly defined parameters as prescribed by senior management of the Bank.

12 Fair Value of Financial Instruments

The following table shows the fair value of the Bank's financial instruments as at 30 June:

(In $ thousands)	2000 Book Value	2000 Fair Value	2000 Favourable (Unfavourable)	1999 Book Value	1999 Fair Value	1999 Favourable (Unfavourable)
Assets						
Cash and deposits with banks	**1,514,813**	**1,514,813**	**–**	1,421,842	1,421,842	–
Investments	**1,831,303**	**1,814,596**	**(16,707)**	1,705,853	1,697,741	(8,112)
Loans	**1,284,223**	**1,287,944**	**3,721**	1,223,159	1,226,189	3,030
Accrued interest	**38,455**	**38,455**	**–**	31,121	31,121	–
Liabilities						
Deposits	**4,337,782**	**4,333,398**	**4,384**	3,901,151	3,896,691	4,460
Securities sold under agreements to repurchase	**54,822**	**54,822**	**–**	207,584	207,584	–
Accrued interest	**9,215**	**9,215**	**–**	15,938	15,938	–
Subordinated debt capital	**75,000**	**72,203**	**2,797**	75,000	74,063	937
Derivative Financial Instruments						
Interest rate swaps	**(30)**	**868**	**898**	1,306	916	(390)
Spot and forward foreign exchange	**732**	**732**	**–**	1,179	1,179	–

The book value of financial assets and financial liabilities held for purposes other than trading may exceed its fair value due primarily to changes in interest rates. In such instances, the Bank does not reduce the book value of these financial assets and financial liabilities to their fair values as it is the Bank's intention to hold them until maturity.

The fair values disclosed exclude premises and equipment and certain other assets and liabilities as these are not financial instruments.

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

Cash and Deposits with Banks

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

Investments

The fair values of investments are based upon quoted market prices.

Loans

The majority of loans are variable rate and repriced in response to changes in market rates and hence the fair value has been estimated as the carrying value. For fixed rate loans, the fair value has been estimated by performing a discounted cash flow calculation using market rates for similar loans made at the balance sheet date.

Accrued Interest

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

Deposits

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

Securities Sold Under Agreements to Repurchase

The fair value of obligations relating to securities sold under repurchase agreements is considered to be equal to the carrying value given their short-term nature.

Subordinated Debt Capital

The fair value of the subordinated debt capital is based on quotes from recognised market makers.

Derivatives

Fair value of exchange traded derivatives are based on quoted market prices. Fair value of over-the-counter derivatives are calculated as the new present value of contractual cash flows using prevailing market rates.

The aggregate of the estimated fair value of amounts presented does not represent management's estimate of the underlying value of the Bank.

13 Interest Rate Risk

The following table sets out the assets, liabilities and off-balance sheet instruments on the date of the earlier of contractual maturity or repricing date. Use of this table to derive information about the Bank's interest rate risk position is limited by the fact that customers may choose to terminate their financial instruments at a date earlier than contractual maturity or repricing date. Examples of this include mortgages, which are shown at contractual maturity but which often pre-pay earlier, and certain term deposits, which are shown at contractual maturity but which are often cashed before their contractual maturity and certain investments which may have call or pre-payment features.

As at 30 June 2000 (In $ millions)	Within 3 mths	After 3 mths but within 6 mths	After 6 mths but within 1 year	After 1 year but within 5 years	After 5 years	Non-interest bearing funds	Total
Assets							
Cash and deposits with banks	1,148	204	146	–	–	17	1,515
Investments	1,307	70	44	360	42	8	1,831
Loans	727	58	59	430	10	–	1,284
Premises and equipment	–	–	–	–	–	97	97
Other assets	–	–	–	–	–	67	67
Total Assets	3,182	332	249	790	52	189	4,794
Liabilities							
Shareholders' equity	–	–	–	–	–	250	250
Deposits	3,479	79	118	238	–	424	4,338
Securities sold under agreements to repurchase	55	–	–	–	–	–	55
Other liabilities	–	–	–	–	–	76	76
Subordinated debt capital	75	–	–	–	–	–	75
Total Liabilities	3,609	79	118	238	–	750	4,794
Off-balance sheet items	25	12	–	(24)	(13)	–	–
Interest rate sensitivity gap	(402)	265	131	528	39	(561)	–
Cumulative interest rate sensitivity gap	(402)	(137)	(6)	522	561	–	–

14 Concentrations of Credit Risk

Concentrations of credit risk exist where clients are engaged in similar activities, are located in the same geographic region or have some other form of commonality such that their ability to meet their contractual obligations would be similarly affected by changes in economic, political or other conditions.

Of the total interest earning assets of $4.61 billion as at 30 June 2000 ($4.35 billion in 1999), 20.3% (23.2% in 1999) relates to the Bermuda market, 19.5% (12.3% in 1999) relates to the United Kingdom market, 4.7% (5.5% in 1999) relates to the Canadian market and 29.2% (36.6% in 1999) to the United States market. No other country accounts for more than 5% of interest earnings assets.

Of the total loan book which amounted to $1.28 billion as at 30 June 2000 ($1.22 billion in 1999), 80.4% (78.7% in 1999) of the lending was in Bermuda, 7.2% (10.7% in 1999) in Europe, 12.4% (10.6% in 1999) in Cayman, and less than 0.1% (less than 0.1% in 1999) in Hong Kong.

15 Subordinated Debt Capital

On 29 June 1998, the Bank issued at par US$75 million of callable step-up subordinated Floating Rate Notes due on 1 July 2008. Interest at US$ 3-month LIBOR plus 65 basis points is payable quarterly in arrears until July 2003 when, if not redeemed, the interest steps up to US$3-month LIBOR plus 115 basis points. Unless previously redeemed or purchased and cancelled, the Notes are redeemable, at their principal amount on 1 July 2008. The Notes will be redeemable, in whole but not in part, at their principal amount on the Interest Payment date falling in July 2003, at the option of the Issuer, subject to the prior consent of the Bermuda Monetary Authority. The Notes may also be redeemed, in whole but not in part, at their principal amount prior to maturity at the option of the Issuer in the event of certain changes affecting tax in Bermuda. The Notes are listed on the Bermuda and Luxembourg Stock Exchanges, and count as Tier 2 capital for capital adequacy purposes.

16 Employee Post-Retirement Medical Benefits Plan

The Bank provides medical benefits to eligible retired employees, their spouses and dependent children.

The amounts recorded by the Bank are based upon an actuarial evaluation using assumptions consistent with those used in the evaluation of the pension plan. The weighted average of the assumed healthcare cost trend rates, the benefit obligation recognised in the Consolidated Balance Sheet and the net medical benefit expense recognised in the Consolidated Statement of Income are presented below:

As at 30 June 2000 (In $ thousands)	2000	1999
Benefit obligation determined by actuarial valuation	**26,104**	24,458
Accrued benefit liability recognised in balance sheet	**32,077**	30,889
Medical benefit expense	**2,007**	1,858
Employer payments of benefits	**819**	922
Weighted average of assumed healthcare cost trend rates	**7.25%**	7.25%

In 1998, the Bank adopted the accrual basis of accounting which requires the accrual of present value of future benefits in the reporting period in which the employee has provided service in exchange for the benefits to be received. The assumed healthcare cost trend rate is currently estimated at 8% per annum, reducing to 5.0% per annum over four years.

17 Stock Option Plan

At the Annual General Meeting of Shareholders held on 29 October 1997, the directors were granted authority to implement a Stock Option Plan for directors and employees. The following table provides information on options granted:

Tranche	Date Granted	Number Granted	Exercise Price	Number Exercised	Number Forfeited	Number Available for Exercise	Vesting Period	Expiry
1	1 July 1998	230,960	$17.90	10	31,890	199,060	25% per annum	1 July 2008
2	1 July 1998	435,363	$16.00	7,725	14,857	412,781	Immediate	1 July 2008
3	1 July 1999	249,856	$16.50	Nil	27,423	222,433	25% per annum	1 July 2009
4	1 July 1999	122,837	$16.00	3,300	Nil	119,537	Immediate	1 July 2009
5	1 July 1999	49,643	$16.00	Nil	Nil	49,643	Immediate	1 July 2009

Tranche 1 Issued to all staff.

Tranche 2 Purchased by certain senior staff from the proceeds of cash bonuses paid to them in respect of the financial year 1997/1998, at the rate of one option for each $2 of bonus paid.

Tranche 3 Issued to all staff.

Tranche 4 Issued to certain senior staff in exchange for Earnings Per Share Unit Options issued in July 1997, at the rate of five and one half options for each Earnings Per Share Unit Option.

Tranche 5 Purchased by directors from the proceeds of attendance fees paid to them, at the rate of one option for each $2 of fees.

The Bank has established a Stock Option Trust, which at 30 June 2000, held 1,928,965 shares (30 June 1999: 1,336,016 shares) purchased from the public and which will be used to satisfy the Bank's obligations with respect to the Stock Option Plan.

18 Discontinued Operations

In 1997, the Bank adopted a formal plan to cease operations at its London Branch, and to exit the trade finance business in the United Kingdom. In light of new circumstances arising during the year the collectability of loans proved more difficult than had been anticipated and as a result the Bank recorded additional provisions.

The analysis of the results for the year in respect of discontinued operations is as follows:

As at 30 June (In $ thousands)	2000	1999
Total income	–	–
Loss from discontinued operations	**14,540**	–

19 Share Buy-back Plan

In 2000 the Bank recommenced its initiative under the Share Buy-back Plan. During the year under review, 612,303 shares were purchased and cancelled at a cost of $10,144.

20 Comparative Figures

Certain 1999 comparative figures have been restated to conform with current year presentation.