

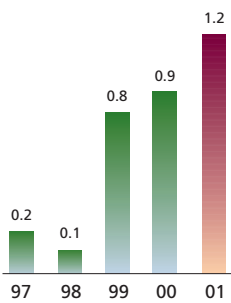


# Management's Analysis of Financial Condition & Review of Operations

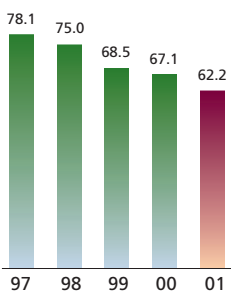


*Bank of Butterfield's Bermuda Call Centre, staffed by friendly, knowledgeable employees, was developed to handle calls from customers requesting information about the Bank, its services and products, and specific customer transactions.*

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.

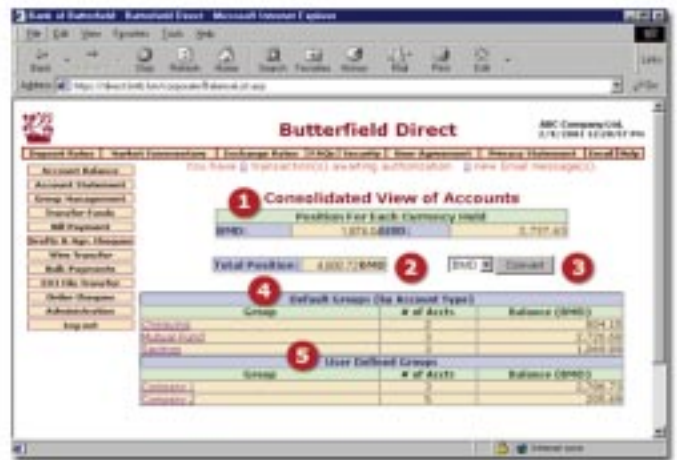
Butterfield Direct is the first Internet Banking product in Bermuda and the first tool that combines the Bank's systems so that customers can access all of their accounts at once.

### 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.

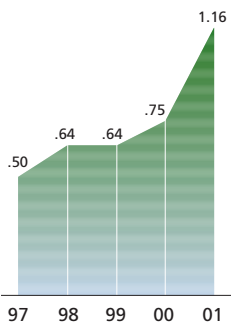
[Go to next Screen](#)

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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**

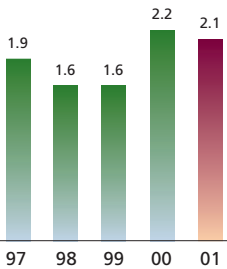
Through our retail operations in five locations, we provide a full range of deposit services, consumer and residential mortgage lending and personal insurance products in Bermuda. Services include a network of 31 Automated Teller Machines (ATMs), credit and debit cards, standing order payments, point 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.



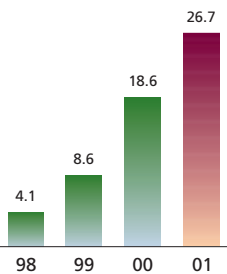
The introduction of Butterfield Direct Internet Banking was the result of the hard work and commitment of a dedicated team. Butterfield Direct is Bermuda's first and, to date, only Internet banking solution.



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**

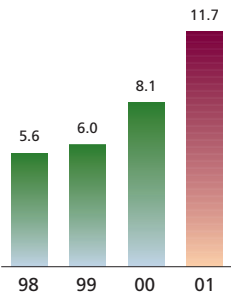
The Corporate Banking group provides a broad range of products and services, including commercial lending and mortgages, cash management, payroll services, remote banking and letters of credit.

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.

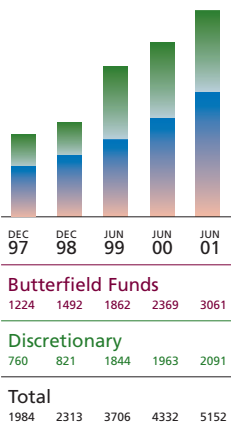




ASSET MANAGEMENT, BERMUDA  
NET INCOME (\$m)



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.

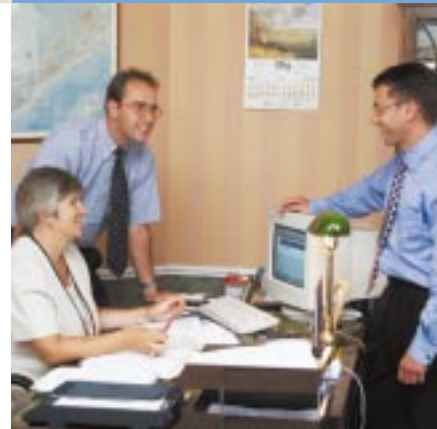
**Asset Management and Administration**

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

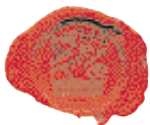


## *Butterfield Asset Management wins performance awards once again!*

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.



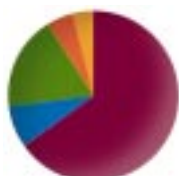
Our new 'Micro' Branch at the Waterfront Centre is an innovative banking concept. It combines modern technology with personal service by using two-way audio/video communication to provide interactive service from a remote teller.

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.