

# Clarien Bank Limited

Consolidated Financial Statements  
(With Independent Auditors' Report Thereon)

Year Ended December 31, 2016



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# Clarien Bank Limited

Consolidated Financial Statements  
(With Independent Auditors' Report Thereon)

Year Ended December 31, 2016



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Independent Auditor's Report

To the Shareholder of Clarien Bank Limited

**Report on the Audit of the Consolidated Financial Statements**

***Opinion***

We have audited the consolidated financial statements of Clarien Bank Limited and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as at December 31, 2016, the consolidated statements of comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at December 31, 2016, and its consolidated financial performance, consolidated changes in equity, and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

***Basis for Opinion***

We conducted our audit in accordance with International Standards on Auditing (ISAs). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Consolidated Financial Statements* section of our report. We are independent of the Group in accordance with the ethical requirements that are relevant to our audit of the consolidated financial statements in Bermuda, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

***Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements***

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRS, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

***Auditor's Responsibilities for the Audit of the Consolidated Financial Statements***

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.



As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the Group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

*KPMG Audit Limited*

Chartered Professional Accountants  
Hamilton, Bermuda  
March 9, 2017

# Consolidated Statement of Financial Position

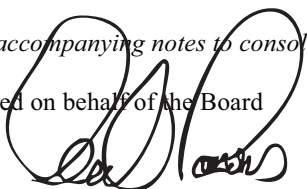



As at December 31, 2016  
(Expressed in thousands of Bermuda dollars)

	<u>Notes</u>	<u>2016</u>	<u>2015</u>
<b>Assets</b>			
Cash and cash equivalents	5	\$ 192,259	\$ 94,344
Investment securities	6	161,633	174,762
Accounts receivable and prepaid expenses	7	3,941	4,496
Accrued interest on cash, deposits with banks and securities		683	442
Loans and advances	8,13	756,375	809,727
Due from related parties	13	7,739	8,363
Investment property	9	3,611	3,745
Property and equipment	10	16,818	17,655
Intangible assets	11	<u>21,393</u>	<u>23,062</u>
<b>Total assets</b>		<u>\$ 1,164,452</u>	<u>\$ 1,136,596</u>
<b>Liabilities</b>			
Due to depositors	12,13	\$ 1,053,698	\$ 1,038,472
Accounts payable and accrued liabilities	14	3,621	2,387
Due to clients		266	106
Deferred income		<u>84</u>	<u>98</u>
<b>Total liabilities</b>		<u>1,057,669</u>	<u>1,041,063</u>
<b>Equity</b>			
Preferred shares	15	20,000	20,000
Common shares	15	5,000	5,000
Contributed surplus	15	22,150	9,550
General reserve	15	10,000	10,000
Retained earnings		51,703	51,267
Accumulated other comprehensive loss		<u>(2,070)</u>	<u>(284)</u>
<b>Total equity</b>		<u>106,783</u>	<u>95,533</u>
<b>Total liabilities and equity</b>		<u>\$ 1,164,452</u>	<u>\$ 1,136,596</u>

See accompanying notes to consolidated financial statements

Signed on behalf of the Board

 Director

 Director

# Consolidated Statement of Comprehensive Income

For the Year Ended December 31, 2016  
(Expressed in thousands of Bermuda dollars)



	<u>Notes</u>	<u>2016</u>	<u>2015</u>
Interest income	16	\$ 53,815	\$ 55,803
Interest expense	16	<u>(10,799)</u>	<u>(10,758)</u>
<b>Net interest income</b>		<u>43,016</u>	<u>45,045</u>
Fee and commission income	17	13,735	13,616
Fee and commission expense	17	<u>(3,398)</u>	<u>(3,066)</u>
<b>Net fee and commission income</b>		<u>10,337</u>	<u>10,550</u>
Net gains on investment securities	6	853	288
Foreign exchange income		568	572
Rent		<u>348</u>	<u>316</u>
<b>Revenue</b>		<u>55,122</u>	<u>56,771</u>
Net impairment loss on financial assets	8	8,563	9,179
Loss on disposition of non performing loans		<u>667</u>	<u>-</u>
<b>Net operating income</b>		<u>45,892</u>	<u>47,592</u>
Personnel expenses	13,19	26,044	26,937
Depreciation and amortisation	9,10,11	4,609	5,245
Other expenses	13,18	<u>14,025</u>	<u>14,888</u>
<b>Total other expenses</b>		<u>44,678</u>	<u>47,070</u>
<b>Profit for the year</b>		<u>\$ 1,214</u>	<u>\$ 522</u>
Other comprehensive loss			
Items that may be reclassified subsequently to profit or loss:			
Net change in unrealized losses on available-for-sale securities		\$ (934)	\$ (44)
Net change in unrealized gains (losses) on equity shares		1	(8)
Reclassification to earnings of net realized gains in the year		<u>(853)</u>	<u>(288)</u>
Other comprehensive loss for the year		<u>(1,786)</u>	<u>(340)</u>
<b>Total comprehensive (loss)/income for the year</b>		<u>\$ (572)</u>	<u>\$ 182</u>

*All amounts included in the consolidated statement of comprehensive income relate to continuing operations.  
See accompanying notes to consolidated financial statements.*

## Consolidated Statement of Changes in Equity

For the Year Ended December 31, 2016  
(Expressed in thousands of Bermuda dollars)



	<u>Note</u>	<u>Preferred shares</u>	<u>Common shares</u>	<u>Contributed surplus</u>	<u>General reserve</u>	<u>Retained earnings</u>	<u>Accumulated other comprehensive (loss)/income</u>	<u>Total</u>
Balance at January 1, 2016		\$ 20,000	\$ 5,000	\$ 9,550	\$ 10,000	\$ 51,267	\$ (284)	\$ 95,533
Total comprehensive income for the year								
Profit for the year		-	-	-	-	1,214	-	1,214
Total other comprehensive loss		-	-	-	-	-	(1,786)	(1,786)
Total comprehensive loss for the year, net of tax		-	-	-	-	1,214	(1,786)	(572)
Capital contribution	15	-	-	12,600	-	-	-	12,600
Preferred share dividends declared	15	-	-	-	-	(778)	-	(778)
Balance at December 31, 2016		\$ 20,000	\$ 5,000	\$ 22,150	\$ 10,000	\$ 51,703	\$ (2,070)	\$ 106,783

See accompanying notes to consolidated financial statements



## Consolidated Statement of Changes in Equity

For the Year Ended December 31, 2015  
(Expressed in thousands of Bermuda dollars)



	<u>Note</u>	<u>Preferred shares</u>	<u>Common shares</u>	<u>Contributed surplus</u>	<u>General reserve</u>	<u>Retained earnings</u>	<u>Accumulated other comprehensive (loss)/income</u>	<u>Total</u>
Balance at January 1, 2015		\$ 20,000	\$ 5,000	\$ 10,800	\$ 10,000	\$ 51,415	\$ 56	\$ 97,271
Total comprehensive income for the year								
Profit for the year		-	-	-	-	522	-	522
Total other comprehensive loss		-	-	-	-	-	(340)	(340)
Total comprehensive income for the year, net of tax		-	-	-	-	522	(340)	182
Capital distribution	15	-	-	(1,250)	-	-	-	(1,250)
Preferred share dividends declared	15	-	-	-	-	(670)	-	(670)
Balance at December 31, 2015		\$ 20,000	\$ 5,000	\$ 9,550	\$ 10,000	\$ 51,267	\$ (284)	\$ 95,533

See accompanying notes to consolidated financial statements

# Consolidated Statement of Cash Flows

For the Year Ended December 31, 2016  
(Expressed in thousands of Bermuda dollars)



	<u>Notes</u>	<u>2016</u>	<u>2015</u>
<b>Cash flows from operating activities</b>			
Profit for the year		\$ 1,214	\$ 522
Adjustments to reconcile net profit to net cash provided by operating activities:			
Depreciation and amortization		4,609	5,245
Amortization of premiums/discounts on fixed income securities		553	910
Net gains on investment securities		(853)	(288)
Net impairment loss on financial assets		8,563	9,179
Loss on disposition of non performing loans		667	-
Net changes in non-cash balances relating to operations:			
Change in accounts receivable and prepaid expenses		555	901
Change in accrued interest on cash, deposits with banks and securities		(241)	28
Change in loans and advances		44,122	57,551
Change in due from related parties		624	(478)
Change in assets held for sale		-	1,500
Change in due to depositors		15,226	(42,934)
Change in accounts payable and accrued liabilities		1,234	(1,074)
Change in due to clients		160	77
Change in deferred income		(14)	(11)
Net cash provided by operating activities		<u>76,419</u>	<u>31,128</u>
<b>Cash flows from investing activities</b>			
Acquisition / reinvestment of available-for-sale securities		(171,033)	(91,105)
Proceeds / maturity of available-for-sale securities		182,676	51,560
Intangible assets acquired	11	(982)	(1,757)
Property and equipment purchased	10	<u>(987)</u>	<u>(697)</u>
Net cash provided by (used in) investing activities		<u>9,674</u>	<u>(41,999)</u>
<b>Cash flows from financing activities</b>			
Preferred share dividends paid	15	(778)	(670)
Capital contribution (distribution)	15	<u>12,600</u>	<u>(1,250)</u>
Net cash provided by (used in) financing activities		<u>11,822</u>	<u>(1,920)</u>
Net increase (decrease) in cash and cash equivalents		97,915	(12,791)
Cash and cash equivalents, beginning of year		<u>94,344</u>	<u>107,135</u>
Cash and cash equivalents, end of year	5	<u>\$ 192,259</u>	<u>\$ 94,344</u>

See accompanying notes to consolidated financial statements

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***1. General**

Clarien Bank Limited (the “Bank” or “CBL”), formerly CAPITAL G Bank Limited, is incorporated under the laws of Bermuda and has a banking license under the Bank and Deposit Companies Act, 1999 (“the Act”). On December 31, 2013 Capital G Limited (“CGL”), the Bank’s former parent company, announced that it had entered into a formal agreement to amalgamate with Clarien Group Limited (“Clarien”), a wholly owned subsidiary of CWH Limited. Post-amalgamation, Clarien was owned 20% by Edmund Gibbons Limited and 80% by CWH Limited, whereby CWH Limited became the ultimate parent company of the Bank. The Bank changed its name from CAPITAL G Bank Limited to Clarien Bank Limited effective April 17, 2014.

On February 9, 2015, Edmund Gibbons Limited (“EGL”) acquired 50% of CWH Limited, which when combined with its existing 20% interest in Clarien, resulted in EGL becoming the controlling shareholder of Clarien and the ultimate parent company of CBL. On April 2, 2015, EGL reacquired the remaining shares it had previously sold in Clarien and is, therefore, the 100% owner of CBL.

The consolidated financial statements of Clarien Bank Limited as at and for the year ended December 31, 2016 comprise Clarien Bank Limited and its subsidiaries (together referred to as the “Bank” and individually as “Bank entities”). The Bank is involved in community banking and provides retail and private banking services to individuals, and commercial banking services to small and medium-sized businesses. The services offered include demand and term deposits, consumer, commercial and mortgage lending, credit and debit cards and letters of credit. The Bank also, through its subsidiary operations, engages in investment management, brokerage and advisory services and trust administration. The address of the Bank’s registered office is 25 Reid Street, Hamilton HM11, Bermuda. The Bank operates out of two locations in Bermuda.

The following lists all directly held subsidiaries of CBL, as well as their directly owned subsidiaries. All subsidiaries are wholly owned.

Legal entity	Activity
First Bermuda Group Limited	Holding company
First Bermuda Securities Limited	Brokerage services; subsidiary of First Bermuda Group Limited
Onshore Nominees Limited	Nominee entity of First Bermuda Group Limited
Offshore Nominees Limited	Nominee entity of First Bermuda Group Limited
Clarien Investments Limited (“CIL”)	Investment management
Clarien Brokerage Limited	Brokerage services; subsidiary of CIL
Clarien Nominees Limited	Nominee entity of CIL
Clarien BSX Services Limited	Trading member of Bermuda Stock Exchange; subsidiary of CIL
Clarien Trust Limited	Trust administration
Clarien UK Limited	Inactive

**2. Basis of preparation***(a) Statement of compliance*

The consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRSs”) as issued by the International Accounting Standards Board (“IASB”).

The consolidated financial statements were authorized for issuance by the Board of Directors on March 9, 2017.

## 2. **Basis of preparation** (continued)

### (b) *Basis of measurement*

The consolidated financial statements have been prepared on the historical cost basis, except for available-for-sale investment securities and derivative instruments that have been measured at fair value.

### (c) *Functional and presentation currency*

These consolidated financial statements are presented in Bermuda dollars, which is also the Bank's functional currency. All amounts have been rounded to the nearest thousand, unless otherwise indicated.

### (d) *Use of estimates and judgments*

The preparation of financial information requires the use of estimates and assumptions about future conditions. The use of available information and the application of judgement are inherent in the formation of estimates, actual results in the future may differ from estimates upon which financial information is prepared. Revisions to accounting estimates, if any, are recognized in the period in which the estimate is revised and in any future periods affected. Management believes that the critical accounting policies, where judgement is necessarily applied, are those which relate to the valuation of loans and advances, investment securities, intangible assets and investment property.

## 3. **Summary of significant accounting policies**

The accounting policies set out below have been applied consistently to all periods presented in these consolidated financial statements and have been applied consistently by the Bank entities.

### (a) *Basis of consolidation*

Entities that are controlled by the Bank are consolidated and are listed in Note 1. Subsidiaries are consolidated from the date the Bank gains control, until the date that control ceases. Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. The Bank manages and administers assets held in trusts and other investment vehicles on behalf of investors. The financial statements of these entities are not included in these consolidated financial statements, except when the Bank controls the entity.

All intra-group transactions and income and expenses arising from intra-group transactions are eliminated on consolidation. The consolidated financial statements have been prepared using uniform accounting policies for like transactions.

### (b) *New standards*

The Bank did not adopt any new standards during the period that had a material impact on the consolidated financial statements.

### (c) *New standards and interpretations not yet adopted*

A number of new standards, amendments to standards and interpretations are effective for annual periods beginning after January 1, 2017, however, the Bank has not applied the following new or amended standards in preparing these consolidated financial statements.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies** (continued)*(c) New standards and interpretations not yet adopted* (continued)*(i) IFRS 9 Financial Instruments*

IFRS 9, published in July 2014, replaces the existing guidance in IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 includes revised guidance on the classification and measurement of financial instruments, a new expected credit loss model for calculating impairment on financial assets, and new general hedge accounting requirements. It also carries forward the guidance on recognition and derecognition of financial instruments from IAS 39.

*Classification and measurement*

The classification and measurement of financial assets will depend on how these are managed and their contractual cashflow characteristics. These factors determine whether the financial assets are measured at amortised cost, fair value through other comprehensive income ('FVOCI') or fair value through profit and loss ('FVPL'). The classification of financial liabilities is essentially unchanged. For certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income.

*Impairment*

The impairment requirements of IFRS 9 apply to financial assets measured at amortised cost and FVOCI, and lease receivables and certain loan commitments and financial guarantee contracts. At initial recognition, allowance (or provision in the case of commitments and guarantees) is required for expected credit losses ('ECL') resulting from default events that are possible within the next 12 months ('12 month ECL'). In the event of a significant increase in credit risk, allowance (or provision) is required for ECL resulting from all possible default events over the expected life of the financial instrument ('lifetime ECL'). Financial assets where 12-month ECL is recognised are considered to be 'stage 1'; financial assets which are considered to have experienced a significant increase in credit risk are in 'stage 2'; and financial assets for which there is objective evidence of impairment so are considered to be in default or other wise impaired are in 'stage 3'.

The assessment of whether credit risk has increased significantly since initial recognition is performed for each reporting period by considering the change in the risk of default occurring over the remaining life of the financial instrument, rather than by considering an increase in ECL.

The assessment of credit risk, and the estimation of ECL, are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of ECL should take into account the time value of money. As a result, the recognition and measurement of impairment is intended to be more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month ECL and the population of financial assets to which lifetime ECL applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

*Hedge accounting*

The general hedge accounting requirements aim to simplify hedge accounting, creating a stronger link between it and risk management strategy and permitting the former to be applied to a greater variety of hedging instruments and risks. The standard does not explicitly address macro hedge accounting strategies, which are being considered in a separate project. To remove the risk of any conflict between existing macro hedge accounting practice and the new general hedge accounting requirements, IFRS 9 includes an accounting policy choice to remain with IAS.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies** (continued)*(c) New standards and interpretations not yet adopted* (continued)*(i) IFRS 9 Financial Instruments* (continued)

39 hedge accounting. The Bank does not currently use hedge accounting and is not anticipating any change in this policy. This section of IFRS 9 is, therefore, unlikely to apply to the Bank, at this present time.

*Transition*

The classification and measurement and impairment requirements are applied retrospectively by adjusting the opening balance sheet at the date of initial application, with no requirement to restate comparative periods. The mandatory application date for the standard as a whole is January 1, 2018.

*IFRS 9 Implementation*

Within the Bank, significant preparatory and design work has taken place focused on the design and testing of an impairment calculation model. The documentation of Group accounting policy, the development of operating and risk modelling methodologies and an impact assessment of the classification and measurement requirements have also been included in the process.

Until models have been fully tested, we will not have a reliable understanding of the potential impact on the financial statements and any consequential effects on regulatory capital requirements. However, management's expectation is that these impacts will be material to the financial statements.

*(ii) IFRS 15 Revenue from Contracts with Customers*

IFRS 15 establishes a comprehensive framework for determining whether, how much and when revenue is recognised. It replaces existing revenue recognition guidance, including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and IFRIC 13 *Customer Loyalty Programmes*. IFRS 15 is effective for annual reporting periods beginning on or after January 1, 2018, with early adoption permitted.

The Bank has assessed the impact of IFRS 15 and it expects that the standard will have no significant effect on the consolidated financial statements.

*(iii) IFRS 16 Leases*

IFRS 16 introduces a new single lessee accounting model and requires a lessee to recognize all assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. IFRS 16 contains expanded disclosure requirements and is effective for annual reporting periods beginning on or after January 1, 2019.

The Bank is assessing the potential impact on its consolidated financial statements resulting from the application of IFRS 16.

*(d) Translation of foreign currencies*

Monetary assets and liabilities denominated in foreign currencies are translated into the functional currency, Bermuda dollars, at the spot rates of exchange prevailing at the reporting date, while associated revenues and expenses are translated into Bermuda dollars at the actual spot rates of exchange prevailing at the date of the transaction. Resulting gains or losses are included in foreign exchange income in the consolidated statement of comprehensive income.

### 3. Summary of significant accounting policies (continued)

#### (e) Cash and cash equivalents

Cash and cash equivalents are carried at amortized cost in the consolidated statement of financial position. For purposes of the consolidated statement of cash flows, the Bank considers all time deposits and interbank loans with an original maturity of 90 days or less, and short-term securities that are readily convertible to known amounts of cash, as equivalent to cash.

#### (f) Customer funds

With the exception of amounts disclosed in Note 5, assets held in a trust, agency or fiduciary capacity for customers are not included in the consolidated statement of financial position, as they are not controlled by the Bank.

#### (g) Financial assets and liabilities

##### Initial recognition

The Bank initially recognizes loans, mortgages and credit card receivables classified as loans and advances and deposits classified as due to depositors on the date they originated. Regular way purchases and sales of financial assets are recognized on the trade date at which the Bank commits to purchase or sell the asset. All other financial assets and liabilities (including assets and liabilities designated at fair value through profit or loss) are initially recognized on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

For an item not carried at fair value through profit or loss, a financial asset or liability is measured at fair value plus transaction costs that are directly attributable to its acquisition or issue. For an item measured at fair value through profit or loss, transaction costs are recognized in profit or loss.

##### De-recognition

The Bank derecognizes a financial asset when the contractual rights to the cash flows from the financial asset expire, or when it transfers the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred, or in which the Bank neither transfers nor retains substantially all the risks and rewards of ownership and it does not retain control of the financial asset. Any interest in transferred financial assets that qualify for de-recognition that is created or retained by the Bank is recognized as a separate asset or liability in the consolidated statement of financial position. On de-recognition of a financial asset, the difference between the carrying amount of the asset (or the carrying amount allocated to the portion of the asset transferred), and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized in other comprehensive income ("OCI") is recognized in profit or loss.

The Bank derecognizes a financial liability when its contractual obligations are discharged, cancelled or expire.

##### Offsetting

Financial assets and liabilities are offset and the net amount presented in the consolidated statement of financial position when, and only when, the Bank has a legal right to set off the recognized amounts and it intends to settle either on a net basis or to settle the asset and liability simultaneously.

Income and expenses are presented on a net basis only when permissible under IFRSs, or for gains and losses arising from a group of similar transactions.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies (continued)***(g) Financial assets and liabilities (continued)*Amortized cost measurement

The amortized cost of a financial asset or liability is the amount at which the financial asset or liability is measured at initial recognition, minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between the initial amount recognized and the maturity amount, minus any reduction for impairment.

Fair value measurement

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal or, in its absence, the most advantageous market to which the Bank has access at that date. The fair value of a liability reflects its non-performance risk.

When available, the Bank measures the fair value of an instrument using quoted prices in an active market for that instrument. A market is regarded as active if quoted prices are readily and regularly available and represent actual and regularly occurring market transactions on an arm's length basis.

If a market for a financial instrument is not active, the Bank estimates fair value using a valuation technique. Valuation techniques include using recent arm's length transactions between knowledgeable, willing parties (if available), reference to the current fair value of other instruments that are substantially the same, discounted cash flow analyses and option pricing models. The chosen valuation technique makes maximum use of market inputs, relies as little as possible on estimates specific to the Bank, incorporates all factors that market participants would consider in setting a price, and is consistent with generally accepted methodologies for pricing such financial instruments. Inputs to valuation techniques represent market expectations and measures of the risk-return factors inherent in the financial instrument. The Bank calibrates valuation techniques and tests them for validity using prices from observable current market transactions in the same instrument or based on other available observable market data.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price, i.e., the fair value of the consideration given or received, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. When the transaction price provides the best evidence of fair value at initial recognition, the financial instrument is initially measured at the transaction price and any difference between this price and the value initially obtained from a valuation model is subsequently recognized in profit or loss on an appropriate basis over the life of the instrument but not later than when the valuation is supported wholly by observable market data or the transaction is closed out.

Assets and long positions are measured at a bid price, liabilities and short positions are measured at an asking price. Where the Bank has positions with offsetting risks, mid-market prices are used to measure the offsetting positions and a bid or asking price adjustment is applied only to the net open position as appropriate. Fair values reflect the credit risk of the instrument and include adjustments to take account of the credit risk of the Bank and the counterparty where appropriate. Fair value estimates obtained from models are adjusted for any other factors, such as liquidity risk or model uncertainties, to the extent that the Bank believes a third-party market participant would take them into account in pricing a transaction.

The Bank did make loans to employees, and to employees of certain other related party companies, at interest rates below the comparable market rate. Such related party loans revert to market rate if the employee leaves the company. The employee loan scheme is no longer offered and loans to employees are now underwritten on an arms-length basis.



December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies (continued)***(g) Financial assets and liabilities (continued)*Fair value measurement (continued)

Reduced rate loans are financial assets and under IAS 39, they are initially recognized at fair value and thereafter at amortized cost. For the Bank's employees, the difference between fair value and the amount of the loan is recorded as a prepaid benefit with a corresponding decrease in the carrying value of loans and advances. The benefit is recognized as an expense over the expected service life of the employee, with a corresponding increase in interest income. For employees of related party companies, the difference between fair value and the amount of the loan is recorded as a related party receivable, when reimbursement of the benefit provided by the Bank is agreed to by the related party or shareholder, or as a capital distribution where no re-imburement has been agreed to by the related party or shareholder, with a corresponding decrease in the carrying value of loans and advances. In addition, for employees of related party companies, the difference between fair value and the amount of the loan is recognized as interest income on loans over the expected service life of those employees, with a corresponding decrease in the carrying value of loans and advances.

Identification and measurement of impairment

At each reporting date, the Bank assesses whether there is objective evidence that financial assets not carried at fair value through profit or loss are impaired. A financial asset or a group of financial assets is impaired when objective evidence demonstrates that a loss event has occurred after the initial recognition of the asset(s), and that the loss event has an impact on the future cash flows of the asset(s) that can be estimated reliably.

Objective evidence that financial assets (including equity securities) are impaired can include significant financial difficulty of the borrower or issuer, default or delinquency by a borrower, restructuring of a loan or advance by the Bank on terms that the Bank would not otherwise consider, indications that a borrower or issuer will enter bankruptcy, the disappearance of an active market for a security, other observable data relating to a group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the group. In addition, for an investment in an equity security, a significant or prolonged decline in its fair value below its cost is objective evidence of impairment.

The Bank considers evidence of impairment for loans and advances and debt securities classified as loans and receivables at both a specific asset and collective level. All individually significant loans and advances and debt securities classified as loans and receivables with indicators of impairment are assessed for specific impairment. Loans and advances and debt securities classified as loans and receivables that are not individually significant or that do not have indicators of impairment, are collectively assessed for impairment by grouping together such loans and advances and debt securities classified as loans and receivables with similar characteristics.

A collective allowance for groups of homogeneous loans is established using a formula approach based on historic data. The methodology uses statistical analysis of historical data on delinquency and collateral trends to estimate the probability of default and expected collateral values respectively. The loss given default is then estimated based on the expected collateral values. The estimate of loss arrived at on the basis of historical information is then reviewed to ensure that it appropriately reflects the economic conditions and product mix at the reporting date. Default rates and loss factors are regularly benchmarked against actual loss experience.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies (continued)***(g) Financial assets and liabilities (continued)*Identification and measurement of impairment (continued)

In assessing the need for collective loss allowances, management considers factors such as credit quality, portfolio size, concentrations and economic factors. In order to estimate the required allowance, assumptions are made to define the way inherent losses are modelled and to determine the required input parameters, based on historical experience and current economic conditions. The accuracy of the allowances depends on the estimates of future cash flows for specific counterparties and the model assumptions and parameters used in determining collective allowances.

Impairment losses on assets carried at amortized cost are measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the loan's original effective interest rate. Impairment losses are recognized in profit or loss and reflected in an allowance against loans, mortgages and credit card receivables. Interest on impaired assets continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

Impairment losses on available-for-sale investment securities are recognized by transferring the cumulative loss that has been recognized in OCI to profit or loss as a reclassification adjustment. The cumulative loss that is reclassified from OCI to profit or loss is the difference between the acquisition cost, net of any principal repayment and amortization, and the current fair value, less any impairment previously recognized in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be objectively related to an event occurring after the impairment loss was initially recognized in profit or loss, the impairment loss is reversed, with the amount of the reversal recognized in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognized in OCI.

The Bank writes off certain loans and advances and investment securities when they are determined to be uncollectible (see Note 8).

Credit card receivables that are contractually 180 days past due are automatically written off.

Designation at fair value through profit or loss

The Bank has designated financial assets and liabilities at fair value through profit or loss in the following circumstances:

- The assets or liabilities are managed, evaluated and reported internally on a fair value basis;
- The designation eliminates or significantly reduces an accounting mismatch which would otherwise arise;
- The asset or liability contains an embedded derivative that significantly modifies the cash flows that would otherwise be required under the contract.

Note 4 sets out the amount of each class of financial asset or liability that has been designated at fair value through profit or loss. A description of the basis for each designation is set out in the note for the relevant asset or liability class.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies (continued)***(h) Investment securities*

Investment securities are initially measured at fair value, plus, in the case of investment securities not at fair value through profit or loss, incremental direct transaction costs, and subsequently accounted for depending on their classification as available-for-sale, or for certain debt securities as loans and receivables.

Debt securities classified as loans and receivables are non-derivative financial assets with fixed or determinable payments that the Bank does not intend to sell immediately or in the near term and that are not quoted in an active market. These securities are measured at amortized cost using the effective interest method. Interest income and amortization of premiums and discounts on debt securities classified as loans and receivables are recorded in interest income.

Available-for-sale investment securities are non-derivative investments that are designated as available-for-sale or are not classified as another category of financial assets. These include investment securities which may be sold in response to, or in anticipation of, changes in interest rates and resulting prepayment risk, changes in funding sources or terms, or to meet liquidity needs. Available-for-sale investment securities are measured at fair value with unrealized gains and losses recognized in OCI until the investment is sold or deemed to be impaired, whereupon the cumulative gains and losses previously recognized in OCI are reclassified to profit or loss as a reclassification adjustment. Interest income, including purchased premiums or discounts on available-for-sale investment securities amortized over the life of the security, is recognized in profit or loss using the effective interest method.

The Bank reviews its available-for-sale securities to identify and evaluate investments that show indications of possible impairment. An investment is considered impaired if its unrealized loss is considered to be other than temporary. In determining whether a loss is other than temporary, factors considered include the extent of the unrealized loss, the length of time that the security has been in an unrealized loss position, the financial condition and near-term prospects of the issuer, and management's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery.

Where a decline in the value of a security classified as available-for-sale is considered to be other than temporary, the security is written down to its realizable value, with the impairment loss being recognized in profit and loss in the consolidated statement of comprehensive income. A subsequent increase in fair value of such securities that can be objectively related to an event that occurred after the impairment was recognized will result in a reversal of the impairment loss in the period in which the event occurs.

*(i) Derivative financial instruments*

Derivative instruments are financial contracts whose value is derived from interest rates, foreign exchange rates, the prices of other instruments or other financial indices. The Bank enters into various derivative contracts in the ordinary course of business, including swaps and foreign exchange forward contracts. These derivative contracts may be exchange traded or privately negotiated in the over-the-counter market with international commercial and investment banks, which act as counterparties to the contracts.

Derivative financial instruments are held for risk management purposes and are measured at fair value in the consolidated statement of financial position with gains and losses being recognised in profit or loss.

The Bank may enter into interest rate swap contracts as part of its interest rate risk management program. Interest rate swap contracts are financial transactions in which two counterparties exchange fixed or floating interest payment streams over a period of time based on rates applied to a defined notional principal amount. Their value is derived from the interest rates specified in the contracts.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies (continued)***(i) Derivative financial instruments (continued)*

The Bank enters into foreign exchange forward contracts as part of its asset and liability management program. Their value is derived from the price difference between the applicable forward rate and the exchange rates specified in the contracts.

*(j) Loans and advances*

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and that the Bank does not intend to sell immediately or in the near term.

Loans and advances are initially measured at fair value plus incremental direct third-party transaction costs, and subsequently measured at their amortized cost using the effective interest method less any allowance for impairment.

*(k) Business combinations*

Business combinations are accounted for using the acquisition method when control is transferred to the Bank. The cost of an acquisition is measured as the aggregate of the consideration transferred, measured at acquisition date fair value and the amount of any non-controlling interest in the acquiree. For each business combination, the Bank elects whether it measures the non-controlling interest in the acquiree either at fair value or at the proportionate share of the acquiree's identifiable net assets. This accounting policy choice is applied consistently to all similar business combination transactions. Acquisition costs incurred are expensed and included in other expenses in the consolidated statement of comprehensive income.

When the Bank acquires a business, it assesses the financial assets and liabilities assumed for appropriate classification and designation in accordance with the contractual terms, economic circumstances and pertinent conditions as at the acquisition date.

Goodwill is initially measured at cost, being the excess of the aggregate of the consideration transferred and the amount recognized for non-controlling interest over the fair value of net identifiable assets acquired and liabilities assumed. If this consideration is lower than the fair value of the net assets of the subsidiary acquired, the difference is recognized immediately in the consolidated statement of comprehensive income.

After initial recognition, goodwill is measured at cost less any accumulated impairment losses. For the purpose of impairment testing, goodwill acquired in a business combination is, from the acquisition date, allocated to the respective Bank cash-generating unit (CGU) that is expected to benefit from the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to that unit.

Where goodwill forms part of a CGU and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount when determining the gain or loss on disposal of the operation. Goodwill disposed of in this circumstance is measured based on the relative values of the operation disposed of and the portion of the CGU retained.

*(l) Property and equipment and related depreciation*Recognition and measurement

Items of property and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Cost includes expenditures that are directly attributable to the acquisition of the asset.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies (continued)***(l) Property and equipment and related depreciation (continued)*Recognition and measurement (continued)

The cost of self-constructed assets includes the cost of materials and direct labour, any other costs directly attributable to bringing the assets to a working condition, the costs of dismantling and removing the items and restoring the site on which they are located and capitalized borrowing costs. Purchased software that is integral to the functionality of the related equipment is capitalized as part of the equipment. When parts of an item of property or equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment.

The gain or loss on disposal of an item of property and equipment is determined by comparing the proceeds from disposal with the carrying amount of the item of property and equipment, and is recognized in other income/other expenses in profit or loss.

When the use of an investment property changes such that it is reclassified as property and equipment, its fair value at the date of reclassification becomes its cost for subsequent accounting purposes.

Subsequent costs

The cost of replacing a component of an item of property or equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to the Bank and its cost can be measured reliably. The carrying amount of the replaced part is derecognized. The costs of the day-to-day servicing of property and equipment are recognized in profit or loss as incurred.

Depreciation

Depreciation is recognized in profit or loss on a straight-line basis over the estimated useful lives of each part of an item of property and equipment since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Artwork and land are not depreciated. The estimated useful lives of the related assets are as follows:

Buildings	30-40 years
Furniture and fixtures	5-15 years
Computer systems and equipment	1-10 years
Leasehold improvements	lesser of lease term or estimated useful life

Depreciation methods, useful lives and residual values are reassessed at each financial year-end and adjusted if appropriate.

*(m) Investment properties*

Investment properties are properties held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services or for administrative purposes. A portion of a dual-use property is classified as an investment property only if the portion could be sold or leased out separately under a finance lease. When a portion of the property could not be sold or leased out under a finance lease separately, the entire property is classified as an investment property if the portion of the property held for the Bank's own use is insignificant.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies (continued)***(m) Investment properties (continued)*

When the use of a property changes such that it is reclassified as an investment property, its fair value at the date of reclassification becomes its cost for subsequent accounting purposes.

Investment property is initially measured at cost. Subsequent to initial recognition, investment property is measured at cost less accumulated depreciation and any impairment losses.

Depreciation is recognized in profit or loss on a straight line basis over the estimated useful lives of investment properties which are considered to be as follows:

Buildings	30-40 years
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Depreciation methods, useful lives and residual values are reassessed at each financial year-end and adjusted if appropriate.

*(n) Intangible assets and related amortization**(i) Goodwill*

Goodwill that arises upon the acquisition of subsidiaries is included in intangible assets. See note 3(k) for further details on the accounting policy with respect to goodwill arising on business combinations upon acquisition. Goodwill is subsequently measured at cost less any impairment losses. An intangible asset is recognized only when its cost can be measured reliably and it is probable that the expected future economic benefits that are attributable to it will flow to the Bank.

*(ii) Computer software*

Computer software is measured at cost less any accumulated amortization and any impairment loss. Computer software is amortised on a straight-line basis over its estimated useful life of between 1-10 years. Subsequent expenditure on software assets is capitalized only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred. Amortization methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

Intangible assets are tested annually for impairment or more frequently if certain indicators of impairment are identified.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies (continued)***(o) Non-current assets held for sale*

Non-current assets are classified separately as held for sale in the consolidated statement of financial position when their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is met only when the sale is highly probable, the asset is available for immediate sale in its present condition, and management is committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. Liabilities directly associated with the assets classified as held for sale and expected to be included as part of the sale transaction are correspondingly also classified separately. Property, plant and equipment and intangible assets once classified as held for sale are not subject to depreciation or amortisation. The net assets and liabilities of a disposal group classified as held for sale are measured at the lower of their carrying amount and fair value less cost to sell.

*(p) Impairment of non-financial assets*

The carrying amounts of the Bank's non-financial assets are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. Goodwill and indefinite-lived intangible assets are tested annually for impairment. An impairment loss is recognised if the carrying amount of an asset or cash generating unit (CGU) exceeds its recoverable amount.

The recoverable amount of an asset or CGU is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects the current market assessment of the time value of money and the risks specific to the asset or CGU. For the purpose of impairment testing, assets are grouped together into the smallest group of assets that generate cash inflows from continuing use that are largely independent of the cash inflows of other assets or CGUs. Subject to an operating segment ceiling test, CGUs to which goodwill has been allocated are aggregated so that the level at which impairment testing is performed reflects the lowest level at which goodwill is monitored for internal reporting purposes. Goodwill acquired in a business combination is allocated to groups of CGUs that are expected to benefit from the synergies of the combination.

Impairment losses are recognised in profit or loss. Impairment losses recognised in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the CGU (group of CGUs), and then to reduce the carrying amounts of the other assets in the CGU (group of CGUs) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. For other assets, an impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies (continued)***(q) Interest income and expense*

Interest income and expense for all interest-bearing financial instruments is recognised in 'interest income' and 'interest expense' in the consolidated statement of comprehensive income using the original effective interest rates of the financial assets or financial liabilities to which they relate. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability or, where appropriate, a shorter period, to the net carrying amount of the financial asset or financial liability. When calculating the original effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but not future credit losses. The calculation includes all amounts paid or received by the Bank that are an integral part of the effective interest rate, including transaction costs and all other premiums or discounts.

Administration fees charged for the granting of mortgages and loans, net of directly attributable origination costs, are deferred and recognized over the contractual life of the mortgage or loan as an adjustment to yield using the effective interest method.

*(r) Fee and commission income and expense*

Fee and commission income includes administration fees, investment and trust management fees and card fees. Fee and commission income and expense is recognized on the accrual basis during the period in which the services are provided.

Investment management fees are based on the net asset value of funds under management. Prepaid fees are deferred until earned.

Banking fees primarily include interchange income, annual fees and late fees. Banking fees are recognized as services are provided.

Fee and commission expense includes sub-advisor fees, banking and credit related fees and commission expenses including the costs of the Bank's credit card rewards program.

*(s) Comprehensive income*

The consolidated statement of comprehensive income forms part of the Bank's consolidated financial statements and displays profit for the year and OCI. Accumulated OCI is a separate component of shareholder's equity. The consolidated statement of comprehensive income reflects changes in accumulated OCI, comprised of changes in unrealized gains and losses on financial assets classified as available-for-sale.

*(t) Leases*

Operating lease payments are recognized as an expense on a straight-line basis over the lease term and included in other expenses in the consolidated statement of comprehensive income.



December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***3. Summary of significant accounting policies** (continued)*(u) Tax*

The Bank is not subject to corporate income taxes on profits or capital gains in Bermuda and no provision for tax has therefore been accrued.

*(v) Dividends on common shares*

Dividends on common shares are recognized as a liability and deducted from equity in the period in which they are declared.

*(w) Defined contribution pension plan*

The Bank operates a defined contribution pension plan. A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an expense in the consolidated statement of comprehensive income when they are due in respect of services rendered before the end of the reporting period.

*(x) Share capital*Share issuance costs

Common shares are classified as equity. Incremental costs directly attributable to the issue of common shares are recognized as a deduction from equity, net of any tax effects.

Preferred shares

Preference share capital is classified as equity if it is non-redeemable, or redeemable only at the Bank's option, and any dividends are discretionary. Dividends thereon are recognized as distributions within equity in the period in which they are declared.

**4. Risk management**

The Bank has exposure to the following risks from the financial instruments it holds.

- credit risk
- liquidity risk
- market risk
- operational risk

This note presents information about the Bank's material exposures to each of the above risks, the Bank's objectives, policies and procedures for measuring and managing risk, and the Bank's management of capital.

**Risk management framework**

The Board of Directors has overall responsibility for the establishment and oversight of the Bank's risk management framework. The Board has established the Audit, Risk, and Governance and Human Resource Committees, which are responsible for approving and monitoring Bank risk management policies in their respective areas. All Board Committees comprise only of non-executive members and report regularly to the Board of Directors on their activities. The Board Committees are supported by the management level Credit, Asset and Liability ("ALCO") and Risk Committees, which are responsible for developing risk management policies and related operational procedures, and reporting in their respective areas.

## 4. **Risk management** (continued)

### **Risk management framework** (continued)

The Bank's risk management policies are established to identify and analyze the risks faced by the Bank, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and procedures are reviewed regularly to reflect changes in market conditions, products and services offered. The Bank, through its training and risk management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Risk Committee has the delegated authority for reviewing the adequacy of the risk management framework in relation to the risks taken by the Bank. The Audit Committee is responsible for monitoring compliance with the Bank's risk management policies and procedures, and is assisted in these functions by Internal Audit. Internal Audit undertakes both regular and ad-hoc reviews of risk management controls and procedures, the results of which are reported to the Audit Committee.

### **Credit risk**

Credit risk is the risk of loss arising from a customer or counterparty failing to meet their financial obligations to the Bank as they fall due. The Bank provides credit through residential and commercial mortgages, secured and unsecured loans and credit cards. Credit risk also arises through other activities not directly related to the provision of services to clients, such as short-term investments and interbank loans relating to liquidity management. Residential and commercial mortgages comprise 92% (December 31, 2015 - 92%) of outstanding loans. All mortgage lending is originated by the Bank and retained and serviced within its personal and business lending units.

Maximum credit risk exposure at December 31, 2016 and December 31, 2015 is the carrying value of financial assets as shown on the consolidated statement of financial position as well as the value of commitments, as set out in Note 21. The consolidated statement of financial position does not take into account any collateral held as security or other credit enhancements.

The types of financial instruments that are most exposed to credit risk are Cash and cash equivalents (Note 5), Investment securities (Note 6), Loans and advances (Note 8), and Due from related parties (Note 13).

### Credit risk: loans and advances

The effective management of credit risk requires the establishment of an appropriate credit risk culture. Key credit risk policies and credit risk management strategies are important elements used to create this culture. The Bank has implemented internal processes and risk-oriented strategies intended to actively identifying, managing, monitoring and reporting credit risk on its mortgage and non-mortgage portfolios. The Bank considers these to be suitable for the nature, scale and complexity of the business. This is supported by policies and internal limits or thresholds with key controls.

The Board of Directors, either directly or through the Risk Committee of the Board, reviews and approves the Bank's credit risk strategy and credit risk policy on a quarterly basis.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***4. Risk management** (continued)**Credit risk** (continued)Credit risk: loans and advances (continued)

The objectives of the credit risk strategy are to ensure that:

- The risk parameters for new underwritings and for the portfolios as a whole are clearly specified;
- Target markets and product offerings are well defined at both the enterprise-wide and business line levels;
- Transactions and limits are managed in a manner that is consistent with the Bank's risk appetite;
- Loans are priced on a risk adjusted basis;
- Loans are appropriately collateralized and collateral is maintained and valued periodically;
- Credit risk is managed from concentration and country risk perspectives; and to
- Maintain sufficient information and data to be able to track and monitor changes over time.

The credit risk policy articulates the credit risk management framework, including:

- Aggregate limits for all lenders, beyond which credit applications must be escalated to the Bank's Credit Committee for approval; and
- Single name/aggregation exposures, beyond which exposures must be reported and reviewed by the Credit Committee, with Board oversight.

The table below provides further information on the Bank's loans and advances, gross of allowances, to retail and commercial customers by payment due status:

	<u>2016</u>		<u>2015</u>	
<b>Not impaired:</b>				
Neither past due or impaired	\$ 636,489	81%	\$ 683,831	82%
<b>Past due, but not individually impaired:</b>				
From 7 days up to 3 months	32,881	4%	36,569	4%
3 to 6 months	4,941	1%	15,284	2%
6 to 12 months	11,286	2%	6,480	1%
Over 12 months	<u>23,506</u>	<u>3%</u>	<u>22,956</u>	<u>3%</u>
	72,614	10%	81,289	10%
<b>Individually impaired loans</b>				
Up to 3 months	9,291	1%	3,096	-
3 to 6 months	1,400	-	1,010	-
6 to 12 months	2,801	-	3,824	-
Over 12 months	<u>65,516</u>	<u>8%</u>	<u>63,253</u>	<u>8%</u>
	79,008	9%	71,183	8%
<b>Total</b> (Note 8)	<u>\$ 788,111</u>	<u>100%</u>	<u>\$ 836,303</u>	<u>100%</u>

Given the Bank's credit policies and procedures, management does not consider loans past due less than seven days as delinquent.

Restructured loans are loans whose terms have been renegotiated due to deterioration in the borrower's financial position. The Bank undertakes such restructuring to maximize collection opportunities and minimize the risk of default. Upon restructuring such loans are no longer considered past due, but are treated as up to date loans for measurement purposes. The revised terms usually include extending maturity, changing the timing of interest payments, amendments to the terms of loan covenants and taking additional collateral, including third party guarantees where needed. Both retail and corporate loans are subject to this policy.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***4. Risk management (continued)****Credit risk (continued)**Credit risk: loans and advances (continued)

For the year-ended December 31, 2016, loans amounting to \$56,709 (December 31, 2015 - \$53,365), that would otherwise be considered impaired based on the present value of collateral related cash flows only, have been restructured.

A substantial portion of the loans and mortgages receivable is due from residents of Bermuda and is secured by residential property in Bermuda. The Bermuda economy is largely dependent upon tourism and international business services and the health of these sectors depends to a large extent upon the strength of the United States and European economies. Therefore an adverse change in these sectors in future periods would have a material adverse impact on the carrying value of the Bank's loans and mortgages receivable.

The type of collateral held can include, but is not limited to: residential real estate, commercial properties, other properties, land, and debentures covering business assets such as receivables and equipment, automobiles, securities portfolios, other chattels and cash deposits. Guarantees from third parties are also taken, however the Bank does not rely extensively on guarantees.

**Aggregate undiscounted fair value of collateral held:**

	<u>2016</u>	<u>2015</u>
Past due but not impaired loans	\$ 124,352	\$ 157,734
Impaired loans	<u>65,100</u>	<u>56,330</u>
	<u>\$ 189,452</u>	<u>\$ 214,064</u>

Credit risk: interbank lending and investment securities

The Bank engages in short-term lending to other bank counterparties and investments in securities as part of its ongoing liquidity management program. Risks are managed within specific counterparty limits approved by the Credit Committee and limits, asset quality plans and criteria set out in the Bank's Investment Policy Statement, which is approved by the Risk Committee of the Board of Directors. The Bank uses the external credit agency ratings by Standard & Poor's ("S&P"), supplemented by internal analysis to manage the risks associated with interbank lending and investment activities.

The table below shows the relative concentrations of the Bank's cash held in local and foreign banks and sovereign securities.

	<u>2016</u>		<u>2015</u>	
<b>Concentration by credit grading</b>				
AAA	\$ -	-	\$ 3,615	4%
AA	162,780	89%	60,291	70%
A	12,937	7%	13,574	16%
Other	<u>7,678</u>	<u>4%</u>	<u>8,120</u>	<u>10%</u>
	<u>\$ 183,395</u>	<u>100%</u>	<u>\$ 85,600</u>	<u>100%</u>
<b>Concentration by region</b>				
North America (including Bermuda)	<u>\$ 183,395</u>	<u>100%</u>	<u>\$ 85,600</u>	<u>100%</u>

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***4. Risk management (continued)****Credit risk (continued)**Credit risk: interbank lending and investment securities (continued)

The table below shows the relative concentrations of the Bank's investment securities.

	<u>2016</u>		<u>2015</u>	
<b>Concentration by credit grading</b>				
AAA	\$ 59,934	37%	\$ 45,023	26%
AA	84,086	52%	122,755	70%
A	16,908	11%	6,772	4%
Other	<u>705</u>	<u>-</u>	<u>212</u>	<u>-</u>
	<u>\$ 161,633</u>	<u>100%</u>	<u>174,762</u>	<u>100%</u>
<b>Concentration by region</b>				
North America (including Bermuda)	\$ 151,688	94%	\$ 164,867	94%
Europe	<u>9,945</u>	<u>6%</u>	<u>9,895</u>	<u>6%</u>
	<u>\$ 161,633</u>	<u>100%</u>	<u>\$ 174,762</u>	<u>100%</u>

US Treasuries, which are rated AA are the largest portfolio holding at December 31, 2016. The remainder of the Bank's investment portfolio are holdings in sovereigns, supra-nationals bonds and high grade corporates.

As at December 31, 2016, 100% (December 31, 2015 - 100%) of the investment securities portfolio was paying interest as expected.

Collateral held as security for investment securities is determined by the nature of the instrument. Debt securities and Treasuries are generally unsecured whereas asset-backed securities and similar instruments are secured by pools of financial assets. The carrying value of asset-backed securities at December 31, 2016 is \$71 (December 31, 2015 - \$83).

**Liquidity risk**

Liquidity risk is the risk that the Bank is not able to meet its financial obligations as they fall due, or can only do so at excessive cost. The Bank's policy is to ensure that sufficient funds are available to meet its ongoing commitments to customers and counterparties, both with respect to the demand for loans and the repayment of deposits, and to maintain the confidence of the marketplace in which the Bank operates.

This is achieved by (i) adhering to a Board approved loan to deposit targets, which may have temporary exceptions approved by the Bank's Asset and Liability Committee ("ALCO"), (ii) adherence to regulatory mandated liquidity coverage ratio (LCR) guidelines, to ensure the Bank has a sufficient level of high-quality liquid assets (HQLA) to survive a significant liquidity stress event over a 30 day time horizon; the LCR is calculated by dividing the total of HQLA over the total net cash outflows of the next 30 days, (iii) maintaining holdings of high quality liquid assets and short maturity interbank placements and (iv) maintaining external counterparty repurchase agreements.

#### 4. **Risk management** (continued)

##### **Liquidity risk** (continued)

The development and implementation of the Bank's liquidity policy is the responsibility of ALCO and is approved by the Risk Committee. The day to day monitoring and management of liquidity is the responsibility of the Treasury Department. The Treasury Department prepares liquidity reports and performs stress tests on a monthly basis and reports the results to ALCO and the Risk Committee.

The Bank transacts only a small number of foreign currency trades, predominantly in GBP, CAD, CHF and EUR, and solely for customer flow purposes. These are mostly foreign exchange spot transactions and are usually fully covered. This mismatch does not represent material market or liquidity risk.

# Notes to Consolidated Financial Statements

December 31, 2016  
 (Expressed in thousands of Bermuda dollars, except as noted)



## 4. Risk management (continued)

### Liquidity risk (continued)

#### Contractual Cashflow analysis of financial liabilities

The table below details the Bank's financial liabilities based on liquidity.

#### December 31, 2016

	Carrying amount	Gross nominal inflow / (outflow)	Repayable on demand	Up to 3 mnths	3-6 mnths	6-12 mnths	1-5years	>5 years
<b>Financial liabilities</b>								
Due to depositors	\$ 1,053,698	\$(1,062,110)	\$ (464,661)	\$ (220,777)	\$ (53,906)	\$ (160,453)	\$ (162,313)	\$ -
Accounts payable and accrued liabilities	3,621	(3,621)	(3,621)	-	-	-	-	-
Due to clients	266	(266)	(266)	-	-	-	-	-
Deferred income	<u>84</u>	<u>(84)</u>	<u>(84)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	\$ 1,057,669	\$(1,066,081)	\$ (468,632)	\$ (220,777)	\$ (53,906)	\$ (160,453)	\$ (162,313)	\$ -
Unrecognized loan commitments	-	(17,880)	-	(9,170)	(395)	-	(4,409)	(3,906)
Financial guarantees and letters of credit	<u>-</u>	<u>(1,521)</u>	<u>-</u>	<u>(890)</u>	<u>(325)</u>	<u>(306)</u>	<u>-</u>	<u>-</u>
<b>Total financial liabilities</b>	<u>\$ 1,057,669</u>	<u>\$(1,085,482)</u>	<u>\$ (468,632)</u>	<u>\$ (230,837)</u>	<u>\$ (54,626)</u>	<u>\$ (160,759)</u>	<u>\$ (166,722)</u>	<u>\$ (3,906)</u>

# Notes to Consolidated Financial Statements

December 31, 2016  
 (Expressed in thousands of Bermuda dollars, except as noted)



## 4. Risk management (continued)

### Liquidity risk (continued)

#### December 31, 2015

	Carrying amount	Gross nominal inflow / (outflow)	Repayable on demand	Up to 3 mnths	3-6 mnths	6-12 mnths	1-5years	>5 years
<b>Financial liabilities</b>								
Due to depositors	\$ 1,038,472	\$(1,051,382)	\$ (427,579)	\$ (188,515)	\$ (51,347)	\$ (145,406)	\$ (238,535)	\$ -
Accounts payable and accrued liabilities	2,387	(2,387)	(2,387)	-	-	-	-	-
Due to clients	106	(106)	(106)	-	-	-	-	-
Deferred income	<u>98</u>	<u>(98)</u>	<u>(98)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
	\$ 1,041,063	\$(1,053,973)	\$ (430,170)	\$ (188,515)	\$ (51,347)	\$ (145,406)	\$ (238,535)	\$ -
Unrecognized loan commitments	-	(7,927)	-	(3,257)	-	(317)	(227)	(4,126)
Financial guarantees and letters of credit	<u>-</u>	<u>(1,751)</u>	<u>-</u>	<u>(890)</u>	<u>(405)</u>	<u>(306)</u>	<u>(150)</u>	<u>-</u>
<b>Total financial liabilities</b>	<u>\$ 1,041,063</u>	<u>\$(1,063,651)</u>	<u>\$ (430,170)</u>	<u>\$ (192,662)</u>	<u>\$ (51,752)</u>	<u>\$ (146,029)</u>	<u>\$ (238,912)</u>	<u>\$ (4,126)</u>



## 4. Risk management (continued)

### Market risk

Market risk is the potential adverse change in Bank income or in the value of the Bank's holdings of financial instruments arising from movements in interest rates, foreign exchange rates or equity prices. The objective of market risk management is to manage and control market risk exposure within acceptable parameters, while optimizing the return on risk.

The Bank's exposure to market risk is governed by a policy approved by the ALCO and ratified by the Risk Committee. The policy sets out the nature of risks which may be taken, and the applicable maximum risk limits. Compliance with risk limits and the Bank's exposure to market risks are reviewed at monthly meetings of the ALCO and quarterly meetings of the Risk Committee. Since the Bank does not engage in proprietary trading activities, its market risk exposure principally arises from its banking activities.

Day to day monitoring and management of market risk is undertaken by the Treasury Department. Exposure to market risk is managed by using hedging instruments or by utilizing natural hedges existing within the variety of financial instruments the Bank holds.

### Interest rate risk

The principal market risk faced by the Bank is interest rate risk. The net interest income and market value of the Bank's assets is exposed to movements in interest rates. Primarily, risk arises when asset and liability principal and interest cash flows have different payment, repricing or maturity dates. Interest rate risk exposure is managed on a continuous basis using a combination of derivative instruments such as interest rate swaps and cash instruments such as loans and deposits.

Periodically, the Bank enters into interest rate swap contracts to manage the risks associated with certain of its deposit products. The Bank hedges selected interest rate exposures through interest rate swap contracts, which are linked to and adjust the interest rate sensitivity of specific deposit liabilities. These hedges may be in the form of modifying exposure to interest rate risk by converting fixed rate deposit liabilities to a floating rate. Any decrease in the value of the contracts is mitigated by a decrease in the fair value of the deposit obligations being hedged under an effective hedge.

The Treasury Department uses a variety of reporting and measurement tools to monitor interest rate risk within the Bank, including Asset-Liability Management ("ALM") analysis of the impact on net interest income and expense for given movements in interest rates and gap analysis in relation to various repricing and maturity scenarios covering the Bank's deposit products.

The ALCO and the Risk Committee review market risk limits, on a regular basis, to ensure there are no breaches.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)*4. **Risk management** (continued)Interest Rate Sensitivity

Interest rate risks are monitored by way of sensitivity analysis. These show the estimated effects of changes in market interest rates that management believes would be reasonably possible over the next twelve months, on net interest income and shareholder's equity as at December 31, 2016. The interest rate sensitivity analysis is based on the assumption that volumes remain stable over the analysis period and that management responds to changes in market interest rates and other risk factors. The interest rate sensitivity analysis does not reflect the movement in the fair value of investment securities from changes in market interest rates, which would be recorded as OCI within equity. In light of the current low interest rate environment, the Bank does not believe it is reasonably possible for there to be a substantial decrease in interest rates.

December 31, 2016

	<u>Increase in net interest income and equity</u>
100 basis point increase	\$ 1,696
200 basis point increase	\$ 3,401

December 31, 2015

	<u>Increase in net interest income and equity</u>
100 basis point increase	\$ 2,905
200 basis point increase	\$ 4,819

The tables on the following page summarizes the repricing periods for assets, liabilities and off-balance-sheet instruments. Items are allocated to time band categories by reference to the earlier of the next contractual interest rate repricing date and the maturity date. Use of this table to derive information about the Bank's interest rate risk position is limited by the fact that customers and other counterparties may choose to terminate their financial instruments at a date earlier than contractual maturity or repricing date. Examples of this include loans, which are shown at the earlier of the next contractual interest rate repricing date and the maturity date, but which may pre-pay earlier, and certain term deposits, which are shown at contractual maturity but which may be withdrawn before their contractual maturity and asset-backed securities which have call or pre-payment features.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)*4. **Risk management (continued)****December 31, 2016 Interest rate repricing table**

	Carrying amount	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
Cash and cash equivalents	\$ 192,259	\$ 153,719	\$ -	\$ -	\$ -	\$ -	38,540
Investment securities	161,633	10,071	9,066	25,000	111,100	6,000	396
Accounts receivable and prepaid expenses	3,941	-	-	-	-	-	3,941
Accrued interest on cash, deposits with banks and securities	683	-	-	-	-	-	683
Loans and advances	756,375	715,526	5,777	18,895	-	-	16,177
Due from related parties	7,739	-	-	-	-	-	7,739
Investment property	3,611	-	-	-	-	-	3,611
Property and equipment	16,818	-	-	-	-	-	16,818
Intangible assets	21,393	-	-	-	-	-	21,393
<b>Total assets</b>	<b>1,164,452</b>	<b>879,316</b>	<b>14,843</b>	<b>43,895</b>	<b>111,100</b>	<b>6,000</b>	<b>109,298</b>
Due to depositors	1,053,698	662,760	32,111	64,283	294,544	-	-
Accounts payable and accrued liabilities	3,621	-	-	-	-	-	3,621
Due to clients	266	-	-	-	-	-	266
Deferred income	84	-	-	-	-	-	84
Equity	106,783	-	-	-	-	-	106,783
<b>Total liabilities and equity</b>	<b>1,164,452</b>	<b>662,760</b>	<b>32,111</b>	<b>64,283</b>	<b>294,544</b>	<b>-</b>	<b>110,754</b>
Interest rate sensitivity gap	\$ -	\$ 216,556	\$ (17,268)	\$ (20,388)	\$ (183,444)	\$ 6,000	\$ (1,456)
Cumulative interest rate sensitivity gap	\$ -	\$ 216,556	\$ 199,288	\$ 178,900	\$ (4,544)	\$ 1,456	\$ -

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)*4. **Risk management (continued)****December 31, 2015 Interest rate repricing table**

	Carrying amount	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
Cash and cash equivalents	\$ 94,344	\$ 69,180	\$ -	\$ -	\$ -	\$ -	25,164
Investment securities	174,762	10,083	35,000	17,769	110,897	-	1,013
Accounts receivable and prepaid expenses	4,496	-	-	-	-	-	4,496
Accrued interest on cash, deposits with banks and securities	442	-	-	-	-	-	442
Loans and advances	809,727	774,915	4,648	16,130	-	-	14,034
Due from related parties	8,363	-	-	-	-	-	8,363
Investment property	3,745	-	-	-	-	-	3,745
Property and equipment	17,655	-	-	-	-	-	17,655
Intangible assets	23,062	-	-	-	-	-	23,062
<b>Total assets</b>	<b>1,136,596</b>	<b>854,178</b>	<b>39,648</b>	<b>33,899</b>	<b>110,897</b>	<b>-</b>	<b>97,974</b>
Due to depositors	1,038,472	582,750	39,932	92,648	323,142	-	-
Accounts payable and accrued liabilities	2,387	-	-	-	-	-	2,387
Due to clients	106	-	-	-	-	-	106
Deferred income	98	-	-	-	-	-	98
Equity	95,533	-	-	-	-	-	95,533
<b>Total liabilities and equity</b>	<b>1,136,596</b>	<b>582,750</b>	<b>39,932</b>	<b>92,648</b>	<b>323,142</b>	<b>-</b>	<b>98,124</b>
Interest rate sensitivity gap	\$ -	\$ 271,428	\$ (284)	\$ (58,749)	\$ (212,245)	\$ -	(150)
Cumulative interest rate sensitivity gap	\$ -	\$ 271,428	\$ 271,144	\$ 212,395	\$ 150	\$ 150	-

## 4. Risk management (continued)

### Fair values

Fair value amounts represent estimates of the consideration that would currently be agreed upon between knowledgeable, willing parties who are under no compulsion to act and are best evidenced by a quoted market price, if one exists. Some of the Bank's financial instruments lack an available trading market. Therefore, the fair values of these instruments have been estimated using present value or other valuation techniques and may not necessarily be indicative of the amounts realisable in an immediate settlement of the instruments. In addition, the calculation of estimated fair value is based on market conditions at a specific point in time and may not be reflective of future fair values.

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

### Cash and cash equivalents

The fair values of cash and deposits with banks approximate their carrying value as they are short-term in nature.

### Investment securities

The fair values of equities and US Treasuries are based upon quoted market prices and the fair values of fixed income securities are based on bid prices, observable market inputs and matrix pricing for less liquid securities. Further information on the fair value of securities is given in Note 6.

### Loans and advances

Fair values have been estimated by performing a discounted cash flow calculation using market rates for similar loans made at the reporting date. Other pertinent information relating to the principal characteristics of loans, mortgages and credit card receivables can be found in Note 8.

### Due to depositors

The fair value of fixed rate deposits has been estimated by discounting the contractual cash flows, using market interest rates offered at the reporting date for deposits with similar terms. The fair values of deposits with no stated maturity date are considered equal to their carrying value as the customer can choose to call these deposits at any time.

### Derivative instruments

The fair values of over-the-counter swap, equity index and foreign exchange forward contracts are calculated as the net present value of contractual cash flows using prevailing market rates or the quoted market price, if one exists.

### Other

The fair values of other financial assets and liabilities approximate their carrying amounts as they are generally due on demand or otherwise earn interest at market interest rates.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***4. Risk management (continued)**

The aggregate of the estimated fair value amounts presented does not represent management's estimate of the underlying value of the Bank, in part because the fair values disclosed exclude property and equipment and certain other assets and liabilities, as these are not financial instruments.

**December 31, 2016**

	Fair value through profit or loss	Fair value through comprehensive income	Amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	\$ -	\$ -	\$ 192,259	\$ 192,259	\$ 192,259
Investment securities	-	161,562	71	161,633	161,633
Loans and advances	-	-	756,375	756,375	757,761
Other assets	-	-	11,691	11,691	11,691
	<u>\$ -</u>	<u>\$ 161,562</u>	<u>\$ 960,396</u>	<u>\$ 1,121,958</u>	<u>\$ 1,123,344</u>
Deposits	\$ -	\$ -	\$ 1,053,698	\$ 1,053,698	\$ 1,058,737
Other liabilities	-	-	3,971	3,971	3,971
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,057,669</u>	<u>\$ 1,057,669</u>	<u>\$ 1,062,708</u>

**December 31, 2015**

	Fair value through profit or loss	Fair value through comprehensive income	Amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	\$ -	\$ -	\$ 94,344	\$ 94,344	\$ 94,344
Investment securities	-	174,679	83	174,762	174,757
Loans and advances	-	-	809,727	809,727	810,945
Other assets	-	-	12,235	12,235	12,235
	<u>\$ -</u>	<u>\$ 174,679</u>	<u>\$ 916,389</u>	<u>\$ 1,091,068</u>	<u>\$ 1,092,281</u>
Deposits	\$ -	\$ -	\$ 1,038,472	\$ 1,038,472	\$ 1,043,845
Other liabilities	-	-	2,591	2,591	2,591
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 1,041,063</u>	<u>\$ 1,041,063</u>	<u>\$ 1,046,436</u>

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)*4. **Risk management** (continued)**Fair value of assets and liabilities classified using the fair value hierarchy**

The Bank measures fair values using the following fair value hierarchy that reflects the significance of the inputs used in making the measurements:

- Level 1: Quoted market price (unadjusted) in an active market for an identical instrument.
- Level 2: Valuation techniques based on observable inputs, either directly (i.e., as prices) or indirectly (i.e., derived from prices). This category includes instruments valued using quoted market prices in active markets for similar instruments; quoted prices for identical or similar instruments in markets that are considered less than active; or other valuation techniques where all significant inputs are directly or indirectly observable from market data.
- Level 3: Valuation techniques using significant unobservable inputs. This category includes all instruments where the valuation technique includes inputs not based on observable data and the unobservable inputs have a significant effect on the instrument's valuation. Level 3 measurements require significant amounts of judgement on the part of management and involve greater degrees of measurement uncertainty.

The following table presents financial instruments measured at fair value classified by the fair value hierarchy.

	December 31, 2016			
	Level 1	Level 2	Level 3	Total
<b>Financial Assets</b>				
<b>Securities - available-for-sale</b>				
US government and agency				
- Treasuries	\$ 59,938	\$ -	\$ -	\$ 59,938
- Agency debt	-	15,057	-	15,057
Other OECD government & government guaranteed and international organizations				
Corporate debt securities	-	56,773	-	56,773
Equities	-	29,160	-	29,160
	-	634	-	634
<b>Total available-for-sale securities</b>	<b>\$ 59,938</b>	<b>\$ 101,624</b>	<b>\$ -</b>	<b>\$161,562</b>

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)*4. **Risk management** (continued)**Fair value of assets and liabilities classified using the fair value hierarchy** (continued)

	December 31, 2015			
	Level 1	Level 2	Level 3	Total
<b>Financial Assets</b>				
<b>Securities - available-for-sale</b>				
US government and agency				
- Treasuries	\$ 100,582	\$ -	\$ -	\$ 100,582
- Agency debt	-	5,020	-	5,020
Other OECD government & government guaranteed and international organizations	-	31,111	-	31,111
Corporate debt securities	-	37,837	-	37,837
Equities	-	129	-	129
<b>Total available-for-sale securities</b>	<b>\$ 100,582</b>	<b>\$ 74,097</b>	<b>\$ -</b>	<b>\$ 174,679</b>

There were no significant transfers between Levels 1, 2 and 3 during the year ended December 31, 2016 (2015-nil).



December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***4. Risk management (continued)****Operational risk**

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events (including legal risk but excluding strategic and reputational risk). The Bank seeks to manage operational risk so as to balance the avoidance of financial losses and damage to its reputation with overall cost effectiveness by implementing suitable control procedures.

The Basel Committee on Banking Supervision's report on "*Sound Practices for the Management and Supervision of Operational Risk*" and the Bermuda Monetary Authority ("BMA")'s May 2007 guidance paper "*The Management of Operational Risk*" heightened the awareness of operational risk and provided a set of minimum quantitative and qualitative standards and risk management practices that a financial institution should have in place to address these risks, thereby establishing an effective operational risk management framework. The Bank's framework is based on this guidance and has been approved by the Audit Committee of the Board and is subject to periodic review and update. In line with the Bank's Enterprise Risk Management ("ERM") framework the primary responsibility for operational risk management is assigned to senior management within each business unit. A centralized risk management function exists to oversee this process and provide regular reporting to the Bank's Governance Risk and Compliance Committee and Audit Committee.

The Bank's operational risk framework is intended to provide:

- Clearly defined Bank strategies;
- Oversight by the Board of Directors and senior management;
- Appropriate segregation of duties, including the independent authorization of transactions;
- Requirements for the reconciliation and monitoring of transactions;
- Compliance with regulatory and other legal requirements;
- Investments in appropriate processing technology and information technology ("IT") security;
- A strong operational risk and internal controls culture;
- Documentation of key policies and procedures;
- Training and professional development;
- Effective requirements for internal reporting;
- Periodic business level risk assessments conducted under the ERM framework; and
- Insurance and robust business contingency planning.

Compliance with Bank standards is supported by a program of periodic reviews undertaken by Internal Audit. The results of Internal Audit reviews and Operational Risk reports are discussed at various levels of management and by the Audit Committee.

## 4. Risk management (continued)

### Capital management

Capital is held to provide a cushion for unexpected losses. The Board sets the internal level of capital with the aim of ensuring minimum regulatory capital levels are always exceeded whilst allowing for growth in the business.

Basel III superseded Basel II and took effect on January 1, 2015 with transitional arrangements until full implementation in 2019. The three pillar framework of Basel II is unchanged but there have been changes to the detailed requirements within each pillar. Pillar 3 has more detailed disclosure requirements and will adopt generic templates over the course of the transition to allow improved comparability and transparency between institutions covered by Basel accords.

The key elements of Basel III changes to capital requirements are as follows:

Changes to the definition of capital and the introduction of common equity Tier 1 (CET1). Over the transition period there will be changes and additions to capital deductions from CET1 and Tier 2 capital, including the available-for-sale reserve.

Higher thresholds for all forms of capital will be required with an increased focus on CET1. A capital conservation buffer of 2.5% will be introduced and phased in over the implementation period. Additionally, a capital surcharge for Domestic Systematically Important Banks ('D-SIB') ranging between 0.5% and 3.0% for all Bermuda Banks has also been implemented.

Introduction of a non-risk based Leverage Ratio, being a measure of Tier 1 capital held against total assets, including certain off-balance sheet financial commitments. The Bank's unaudited leverage ratio was 8.56% as at December 31, 2016, which is above the minimum proposed by the Bermuda Monetary Authority of 5.0%.

The Bank has complied with all externally imposed minimum capital requirements throughout the current year.

The new Basel rules also address areas of liquidity. The authority has adopted a Liquidity Coverage Ratio ('LCR') with phased-in implementation consistent with that published by the Basel Committee. The LCR aims to ensure Banks have sufficient stock of unencumbered highly liquid assets to survive a high liquidity stressed scenario lasting 30 days. Further information regarding the implementation of Basel III can be found on the Bermuda Monetary Authority's website ([www.bma.bm](http://www.bma.bm)).

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)*4. **Risk management** (continued)**Capital management** (continued)

The Bank reports its regulatory capital position to the BMA on a consolidated legal entity basis each calendar quarter. The position, as reported to the BMA, at December 31 was as follows.

	Unaudited <u>2016</u>	Unaudited <u>2015</u>
<b>Tier 1 capital</b>		
Preferred share capital	\$ 20,000	\$ 20,000
Common share capital	5,000	5,000
Contributed surplus	18,550	5,950
General reserve	10,000	10,000
Current year's retained profit, reviewed by external auditors, after dividends	1,214	522
Retained earnings and other reserves	52,771	52,860
Goodwill	<u>(7,456)</u>	<u>(7,456)</u>
<b>Total Tier 1 capital</b>	<u>\$ 100,079</u>	<u>\$ 86,876</u>
<b>Tier 2 capital</b>		
Fixed assets revaluation reserves	\$ -	\$ 668
Collective allowance for credit losses	<u>5,626</u>	<u>5,902</u>
<b>Total Tier 2 capital</b>	<u>\$ 5,626</u>	<u>\$ 6,570</u>
<b>Total Tier 1 and 2 capital</b>	<u>\$ 105,705</u>	<u>\$ 93,446</u>
<b>Capital ratios</b>		
Tier 1 capital	16.53%	15.29%
Total capital	17.46%	16.45%

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***5. Cash and cash equivalents**

	<u>2016</u>	<u>2015</u>
Cash in vault	\$ 8,864	\$ 8,744
Cash at local banks	12,923	13,567
Cash at foreign banks	<u>55,499</u>	<u>53,424</u>
	\$ 77,286	\$ 75,735
Other cash equivalents	<u>\$ 114,973</u>	<u>\$ 18,609</u>
<b>Total Cash and cash equivalents</b>	<b><u>\$ 192,259</u></b>	<b><u>\$ 94,344</u></b>

Cash at foreign banks of \$55,499 (2015 - \$53,424) includes \$40,419 (2015 - \$38,960) held in US dollars and \$15,080 (2015 - \$14,464) held in other foreign currencies. The average effective interest rate earned on cash and deposits with banks for the year ended December 31, 2016 was 0.03% (2015 - 0.09%).

Cash and deposits with banks includes \$266 (2015 - \$106) of restricted funds held in escrow on behalf of customers, and \$5,005 (2015 - \$5,004) pledged to collateralise standby letters of credit issued on behalf of customers.

As at December 31, 2016, foreign currency interest bearing deposits with banks of \$38,719 includes \$15,080 denominated in foreign currencies other than US dollar (2015: \$50,572 included \$14,464). As at December 31, 2016 and December 31, 2015, all other cash and deposits with banks are denominated in Bermuda dollars or in US dollars.

Other cash equivalents include highly-liquid sovereign securities with a term to maturity of 90 days or less from the date of acquisition.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***6. Investment securities**

The fair value of the Bank's securities may be affected by changes in the level of prevailing interest rates. In the event that interest rates rise then the fair value of fixed income instruments would decrease. The tables below indicate the carrying value, fair value and remaining term to maturity of the Bank's fixed income securities at December 31, 2016 and December 31, 2015.

No investment securities have been pledged (2015 - \$0) as collateral to third parties.

	December 31, 2016					
	Maturing Within <u>1 year</u>	Maturing in 1 to 5 <u>years</u>	Maturing after 5 <u>years</u>	With no specific <u>maturity</u>	Carrying <u>Amount</u>	<u>Fair value</u>
<b>Available-for-sale</b>						
<b>Fixed Income</b>						
US government and agency						
- Treasuries	\$ 14,934	\$ 45,004	\$ -	\$ -	\$ 59,938	\$ 59,938
- Agency debt	5,015	10,042	-	-	15,057	15,057
Other OECD government & government guaranteed and international organizations	-	51,119	5,654	-	56,773	56,773
Corporate debt securities	<u>19,098</u>	<u>10,062</u>	<u>-</u>	<u>-</u>	<u>29,160</u>	<u>29,160</u>
<b>Total – fixed income</b>	<u>39,047</u>	<u>116,227</u>	<u>5,654</u>	<u>-</u>	<u>160,098</u>	<u>160,098</u>
<b>Equities</b>						
Equities	<u>-</u>	<u>-</u>	<u>-</u>	<u>634</u>	<u>634</u>	<u>634</u>
<b>Total – available-for-sale</b>	<u>\$ 39,047</u>	<u>\$ 116,227</u>	<u>\$ 5,654</u>	<u>\$ 634</u>	<u>\$ 161,562</u>	<u>\$ 161,562</u>
<b>Debt securities classified as loans and receivables</b>						
Asset-backed securities	\$ -	\$ -	\$ 71	\$ -	\$ 71	\$ 68
<b>Total investment securities</b>	<u>\$ 39,047</u>	<u>\$ 116,227</u>	<u>\$ 5,725</u>	<u>\$ 634</u>	<u>\$ 161,633</u>	<u>\$ 161,630</u>
Average effective interest rate	1.09%	1.14%	3.55%	- %	1.21%	

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)*6. **Investment securities** (continued)

	December 31, 2015					
	Maturing Within 1 year	Maturing in 1 to 5 years	Maturing after 5 years	With no specific maturity	Carrying Amount	Fair value
<b>Available-for-sale</b>						
<b>Fixed Income</b>						
US government and agency						
- Treasuries	\$ 29,995	\$ 70,587	\$ -	\$ -	\$ 100,582	\$ 100,582
- Agency debt	-	5,020	-	-	5,020	5,020
Other OECD government & government guaranteed and international organizations	15,064	16,047	-	-	31,111	31,111
Corporate debt securities	18,594	19,243	-	-	37,837	37,837
<b>Total – fixed income</b>	<b>63,653</b>	<b>110,897</b>	<b>-</b>	<b>-</b>	<b>174,550</b>	<b>174,550</b>
<b>Equities</b>						
Equities	-	-	-	129	129	129
<b>Total – available-for-sale</b>	<b>\$ 63,653</b>	<b>\$ 110,897</b>	<b>\$ -</b>	<b>\$ 129</b>	<b>\$ 174,679</b>	<b>\$ 174,679</b>
<b>Debt securities classified as loans and receivables</b>						
Asset-backed securities	\$ -	\$ -	\$ 83	\$ -	\$ 83	\$ 78
<b>Total investment securities</b>	<b>\$ 63,653</b>	<b>\$ 110,897</b>	<b>\$ 83</b>	<b>\$ 129</b>	<b>\$ 174,762</b>	<b>\$ 174,757</b>
Average effective interest rate	0.51%	1.12%	1.23%	- %	0.89%	

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***6. Investment securities (continued)**

Actual maturities may differ from the stated maturities reflected above because certain securities may have call or prepayment features. Asset-backed securities are shown at their legal final maturity and not their estimated weighted average life.

The Bank held asset-backed securities all of which are rated B or above by Standard & Poor's with an amortized cost totalling \$71 and fair value totalling \$68 (2015 - \$83 and \$78 respectively).

Depending on market conditions, the Bank could incur additional realized and unrealized investment losses in future periods. However, given that the asset backed securities are high-quality and management has the ability and intent to hold these investments until there is a recovery of the unrealized loss, which may be at maturity, management believes it is probable that the Bank will be able to collect the principal amount of these securities according to the original contractual terms of the investments. As such, management does not consider any of these investments to be impaired as at December 31, 2016.

Fair values for fixed income securities are obtained from independent pricing services. The independent pricing services obtain actual transaction prices for securities that have quoted prices in active markets and have their own proprietary methods for determining the fair value of securities that are not actively traded. In general, the independent pricing services use "matrix pricing" which utilises observable market inputs including, but not limited to, broker quotes, interest rates, yield curves, prepayment speeds, default rates and such other inputs as are available from market sources to determine a reasonable fair value.

**Net gains on investment securities are made up of:**

	<u>2016</u>	<u>2015</u>
Net realized gains on sale of:		
Available for sale securities	\$ <u>811</u>	\$ <u>288</u>
Recoveries on:		
Debt Securities classified as loans	\$ <u>42</u>	\$ <u>-</u>
<b>Total</b>	<b>\$ <u>853</u></b>	<b>\$ <u>288</u></b>

**7. Accounts receivable and prepaid expenses**

The Bank's accounts receivable and prepaid expenses, are as follows:

	<u>2016</u>	<u>2015</u>
Prepaid staff loan benefit	\$ 863	\$ 1,065
Management fees, trail commissions and custody fees receivable	1,926	1,882
Other prepaid expenses	672	1,066
Accounts receivable	<u>480</u>	<u>483</u>
<b>Total</b>	<b>\$ <u>3,941</u></b>	<b>\$ <u>4,496</u></b>

# Notes to Consolidated Financial Statements

December 31, 2016

(Expressed in thousands of Bermuda dollars, except as noted)



## 8. Loans and advances

The Bank's loans and advances, net of unamortized deferred administration fees and the allowance for credit losses, are as follows:

	<u>2016</u>	<u>2015</u>
Residential mortgages	\$ 640,120	\$ 689,769
Commercial mortgages	87,925	80,410
Loans and advances - secured	52,026	58,545
Loans and advances - unsecured	1,555	1,413
Credit card receivables	<u>6,485</u>	<u>6,166</u>
	788,111	836,303
Allowance for credit losses on loans, mortgages and credit card receivables	<u>(31,736)</u>	<u>(26,576)</u>
	<u>\$ 756,375</u>	<u>\$ 809,727</u>

The following table provides an analysis of remaining contractual maturities of loans and advances to customers:

	<u>2016</u>		<u>2015</u>			
	<u>Amortized cost</u>	<u>Fair value</u>	<u>Amortized cost</u>	<u>Fair value</u>		
Maturity analysis						
One year or less	\$ 19,524	3%	\$ 19,571	\$ 74,318	9%	\$ 75,836
More than one year	<u>736,851</u>	<u>97%</u>	<u>738,190</u>	<u>735,409</u>	<u>91%</u>	<u>735,109</u>
	<u>\$ 756,375</u>	<u>100%</u>	<u>\$ 757,761</u>	<u>\$ 809,727</u>	<u>100%</u>	<u>\$ 810,945</u>

The loan fair values disclosed above are based on weighted average estimated remaining maturities and are determined using a valuation technique supported by observable market rates. Additional information about the interest rate risk exposure pertaining to loans and advances to customers is presented in Note 4.



December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***8. Loans and advances (continued)**

The Bank had the following loans and advances that are considered to be impaired:

	<u>2016</u>	<u>2015</u>
Residential and commercial mortgages:		
Gross loans	\$ 71,934	\$ 64,672
Specific allowance	<u>(22,714)</u>	<u>(18,148)</u>
Net mortgages	<u>49,220</u>	<u>46,524</u>
Loans and chattel mortgages:		
Gross loans	7,074	6,511
Specific allowance	<u>(3,396)</u>	<u>(2,526)</u>
Net loans and chattel mortgages	<u>3,678</u>	<u>3,985</u>
	<u>\$ 52,898</u>	<u>\$ 50,509</u>

The majority of mortgages are secured by Bermuda residential property. Mortgages receivable are repayable in monthly or periodic instalments generally over periods not exceeding 30 years (2015 - 30 years). At December 31, 2016 the weighted average time remaining to maturity for mortgages was 17 years (2015 - 18 years). At December 31, 2016 loans and chattel mortgages are repayable in monthly or periodic instalments generally over periods not exceeding 7 years (2015 - 7 years), and may be amortized or may be payable in total at maturity with interest being paid monthly. The Bank holds deeds on properties, guarantees and other assets in connection with certain loans and mortgages. Other loans receivable are in the form of unsecured promissory notes. Credit card receivables bear interest at 12% to 22.75% (2015 - 12% to 19.95%) and are unsecured.

The average effective interest rate on total loans and mortgages receivable at December 31, 2016 is 6.31% (2015 - 6.07%).

Total loans include \$45,907 (2015 - \$43,543) denominated in US dollars.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***8. Loans and advances (continued)**

At December 31, 2016, loans, mortgages and credit card receivables included \$343 (2015 - \$393) receivable from directors, and \$54,866 (2015 - \$65,556) receivable from employees of the Bank or employees of the related party companies. Mortgages and loans receivable from directors and employees are part of the Bank's staff loan program, which offers interest rates ranging from 1.99% to 6.00% (2015 - 2.50% to 5.63%), which are below those offered to unrelated parties but above the cost of funds. All other terms of staff loans are the same as those granted to unrelated parties.

**Allowance for credit losses**

The allowance for credit losses is deducted from loans, mortgages and credit card receivables in the consolidated statement of financial position. Changes in the allowance for credit losses are comprised of the following:

	<u>2016</u>	<u>2015</u>
Specific allowances for impairment:		
Balance at 1 January	\$ 20,674	\$ 17,990
Impairment loss for the year:		
Charge for the year, net	8,839	7,993
Write-offs	(3,710)	(5,777)
Recoveries	<u>307</u>	<u>468</u>
Balance at 31 December	<u>26,110</u>	<u>20,674</u>
Collective allowances for impairment:		
Balance at 1 January	5,902	4,716
Impairment loss for the year:		
(Release) / charge for the year, net	<u>(276)</u>	<u>1,186</u>
Balance at 31 December	<u>5,626</u>	<u>5,902</u>
	<u>\$ 31,736</u>	<u>\$ 26,576</u>

Write-offs during the years ended December 31, 2016 and 2015 relate primarily to charge-offs of principal and suspended accrued interest on impaired loans. Such amounts are initially provided for in the consolidated Statement of Comprehensive Income in "net impairment loss on financial assets" and subsequently written off as incurred.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***9. Investment property****Cost**

At January 1, 2015 \$ 4,994

At December 31, 2015 \$ 4,994

At December 31, 2016 \$ 4,994

**Amortization and impairment losses**

At January 1, 2015 \$ 1,114

Amortization for the year 135

At December 31, 2015 \$ 1,249

Amortization for the year \$ 134

At December 31, 2016 \$ 1,383

**Carrying value**

At December 31, 2015 \$ 3,745

At December 31, 2016 \$ 3,611

The fair value of investment property as at December 31, 2016 is \$3,880 (2015 - \$3,880). Investment property consists of one property with a carrying value of \$3,611 (2015 - \$3,745). One floor of this property, which has been independently assessed as 18% of the total leasable area of the building, was reclassified to property and equipment, due to the Bank using it as corporate offices, from 2013.

Management has tested the carrying value of investment property at December 31, 2016 for impairment and found the recoverable amount to be greater than the carrying value. In determining the recoverable amount an independent appraisal and value-in-use model was used. In accordance with an independent appraisal a discount factor of 7% (2015 - 7%) was applied to the value-in-use cash flow projections to determine the net present value.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***10. Property and equipment**

Property and equipment held by the Bank are as follows:

	<u>Buildings</u>	<u>Furniture and fixtures</u>	<u>Computer hardware and equipment</u>	<u>Artwork</u>	<u>Leasehold improvements</u>	<u>Total</u>
<b>Cost</b>						
Balance at January 1, 2015	13,597	5,965	14,270	606	11,851	46,289
Additions	-	110	456	-	131	697
Write-offs	-	(23)	-	-	-	(23)
Balance at December 31, 2015	13,597	6,052	14,726	606	11,982	46,963
Balance at January 1, 2016	13,597	6,052	14,726	606	11,982	46,963
Additions	7	39	810	-	131	987
Write-offs	-	-	-	-	-	-
Balance at December 31, 2016	13,604	6,091	15,536	606	12,113	47,950
<b>Accumulated depreciation</b>						
Balance at January 1, 2015	4,722	4,870	12,649	-	4,867	27,108
Write-offs	-	(23)	-	-	-	(23)
Depreciation charge for the year	346	266	1,002	-	609	2,223
Balance at December 31, 2015	5,068	5,113	13,651	-	5,476	29,308
Balance at January 1, 2016	5,068	5,113	13,651	-	5,476	29,308
Write-offs	-	-	-	-	-	-
Depreciation charge for the year	345	248	600	-	631	1,824
Balance at December 31, 2016	5,413	5,361	14,251	-	6,107	31,132
<b>Carrying amounts</b>						
Balance at December 31, 2015	\$ 8,529	\$ 939	\$ 1,075	\$ 606	\$ 6,506	\$ 17,655
Balance at December 31, 2016	\$ 8,191	\$ 730	\$ 1,285	\$ 606	\$ 6,006	\$ 16,818

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***11. Intangible assets**

Intangible assets are as follows:

	<u>Computer software</u>	<u>Goodwill</u>	<u>Total</u>
<b>Cost</b>			
Balance at January 1, 2015	\$ 24,649	\$ 7,456	\$ 32,105
Additions	1,757	-	1,757
Write-offs	<u>(67)</u>	<u>-</u>	<u>(67)</u>
Balance at December 31, 2015	<u>\$ 26,339</u>	<u>\$ 7,456</u>	<u>\$ 33,795</u>
Balance at January 1, 2016	\$ 26,339	\$ 7,456	\$ 33,795
Additions	982	-	982
Write-offs	<u>(26)</u>	<u>-</u>	<u>(26)</u>
Balance at December 31, 2016	<u>\$ 27,295</u>	<u>\$ 7,456</u>	<u>\$ 34,751</u>
<b>Accumulated amortization</b>			
Balance at January 1, 2015	\$ 7,913	\$ -	\$ 7,913
Write-offs	(67)	-	(67)
Amortization charge for the year	<u>2,887</u>	<u>-</u>	<u>2,887</u>
Balance at December 31, 2015	<u>\$ 10,733</u>	<u>\$ -</u>	<u>\$ 10,733</u>
Balance at January 1, 2016	\$ 10,733	\$ -	\$ 10,733
Write-offs	(26)	-	(26)
Amortization charge for the year	<u>2,651</u>	<u>-</u>	<u>2,651</u>
Balance at December 31, 2016	<u>\$ 13,358</u>	<u>\$ -</u>	<u>\$ 13,358</u>
<b>Carrying amounts</b>			
Balance at December 31, 2015	<u>\$ 15,606</u>	<u>\$ 7,456</u>	<u>\$ 23,062</u>
Balance at December 31, 2016	<u>\$ 13,937</u>	<u>\$ 7,456</u>	<u>\$ 21,393</u>

Capitalised software is amortised when the assets become available for use and is accounted for on a straight line basis over the expected useful life of the asset.

## 11. **Intangible assets** (continued)

The Bank performs analyses of unamortised intangible assets on an annual basis or more frequently if indicators of impairment exist. If actual results are not consistent with management's assumptions and estimates, the Bank may be exposed to an additional impairment charge associated with unamortised intangible assets.

Impairment is measured as the excess of the carrying amount over the estimated recoverable amount, being the higher of fair value or value in use.

The test methods employed in performing the analyses involve assumptions concerning interest and discount rates, growth projections and other assumptions of future business conditions. The assumptions employed are based on management's judgment using internal and external data. Management utilizes independent valuation experts, if needed.

Management completed its annual impairment testing for intangible assets using the methodology described herein. The impairment test for the Bank's CGU's goodwill is based on management's business forecast in a detailed planning period of three years. For impairment testing, a growth rate of nil% was assumed for the period after the end of the detailed planning period. A discount rate of 10%, being the Bank's estimated cost of capital, was used to determine the net present value of the estimated cash flows.

Accordingly, it was ascertained that no impairment was needed for the intangible assets carried in the financial statements.

The key assumptions described above may change as economic and market conditions change. The Bank estimates that reasonably possible changes in these assumptions are not expected to cause the recoverable amount of the Bank's CGU's to decline below the carrying amount.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***12. Due to depositors**

Total deposits include \$353,624 (2015 - \$324,640) denominated in US dollars and \$16,096 (2015 - \$19,101) denominated in other foreign currencies. In 2016, the average effective interest rate paid on demand deposits increased, compared to 2015, reflecting the US Federal Reserve increase in the federal funds rate in December 2016. The Bank has \$106,477 (2015 - \$74,796) of deposits bearing interest rates linked to the federal funds rate, all denominated in US dollars.

The following is a summary of interest bearing deposits classified by period remaining to expected maturity as at December 31:

	<u>2016</u>		<u>2015</u>	
	<u>Average effective interest rate</u>	<u>Amount</u>	<u>Average effective interest rate</u>	<u>Amount</u>
Demand	0.18%	\$ 464,309	0.12%	\$ 428,011
Up to 3 months	1.05%	183,924	0.59%	143,825
3 - 6 months	0.80%	32,362	0.94%	39,932
6 - 12 months	1.35%	64,283	2.06%	92,648
1 - 5 years	2.32%	<u>294,544</u>	2.21%	<u>323,143</u>
Total	1.03%	1,039,422	1.05%	1,027,559
Accrued interest		<u>14,276</u>		<u>10,913</u>
Total		<u>\$ 1,053,698</u>		<u>\$ 1,038,472</u>

**13. Related party transactions and balances**

Related parties include the parent entity, companies under common control, directors and their affiliates.

All related party transactions are in the normal course of operations and are measured at the exchange amount, which is on an arm's length basis as agreed to by the related parties.

Amounts listed in the consolidated statement of financial position as due from related parties have no stated maturity date or repayment terms, are unsecured and carry interest at 5% (2015 - 5%).

The work force of the Bank included 16 key management employees in 2016 (2015 - 15). During the year ended December 31, 2016, salaries, benefits and directors fees totalling \$4,325 (2015 - \$3,987) were paid to key management employees of the Bank. In addition there are 8 (2015 - 7) directors who are considered key management personnel.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)*13. **Related party transactions and balances** (continued)**Consolidated Statement of Comprehensive Income**

	<u>2016</u>	<u>2015</u>
Interest income	\$ 1,611	\$ 1,458
Interest expense	\$ 562	\$ 675
Fee and commission income	\$ 3,799	\$ 3,578
Fee and commission expense	\$ -	\$ 120
Personnel expenses	\$ 4,886	\$ 4,490
Other expenses	\$ 2,960	\$ 2,831
Rent	\$ 205	\$ 185

Included in other expenses are \$ nil (2015 - \$120) paid to Gibbons Management Services Limited (“GMSL”) for group-allocated administrative overheads, and \$366 (2015 - \$446) paid to key management employees. GMSL is ultimately owned by the Bank’s shareholders. Personnel expenses includes \$3,959 (2015 - \$3,541) paid to key management personnel. The remainder of other expenses relates to transactions with companies under common control. In the summary above, all fee and commission income, fee and commission expense, personnel expenses and rent relate to transactions with companies under common control.

During the year ended December 31, 2016, the Bank recharged \$95 (2015 - \$95) to companies under common control, representing portions of certain expenses provided by the Bank. Of this amount, \$78 (2015 - \$48) has been included in personnel expenses and \$47 (2015 - \$47) has been included in other expenses in the consolidated statement of comprehensive income.

**Consolidated Statement of Financial Position**

	<u>2016</u>	<u>2015</u>
Related party balances - Included in assets		
Loans and advances (Key management personnel)	\$ 8,509	\$ 7,124
Loans and advances (Entities with significant influence)	\$ 17,094	\$ 17,394
Loans and advances (Companies under common control)	\$ 463	\$ 933
Accounts receivable and prepaid expenses (Companies under common control)	\$ 3	\$ 2
Due from related parties (Parent)	\$ 6,206	\$ 6,546
Due from related parties (Companies under common control)	\$ 1,533	\$ 1,817
Related party balance - Included in liabilities		
Due to depositors (Key management personnel)	\$ 4,130	\$ 3,387
Due to depositors (Companies under common control)	\$ 77,390	\$ 73,782
Accounts payable and accrued liabilities (Companies under common control)	\$ 87	\$ 156

The deposits are taken as part of the Bank’s ordinary course of business and on the same terms as deposits held for unrelated parties.



December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***14. Accounts payable and accrued liabilities**

The Bank's accounts payable and accrued liabilities are as follows:

	<u>2016</u>	<u>2015</u>
Accounts payable	\$ 353	\$ 423
Accrued liabilities	2,881	1,300
Bonus payable	-	400
Foreign currency tax payable	294	162
Visa rewards payable	<u>93</u>	<u>102</u>
Total	<u>\$ 3,621</u>	<u>\$ 2,387</u>

**15. General reserve, retained earnings and contributed surplus**

The total authorized, issued and fully paid Bermuda dollar common share capital is 4,999,999 (2015 - 4,999,999) with a par value of \$1 per share. Common shares carry no right to regular dividends. The Bank also has 20,000,000 (2015 - 20,000,000) authorized, issued and fully paid US dollar redeemable, floating rate preferred shares with non-cumulative dividends with a par value of \$1 per share.

During the year ended December 31, 2016, dividends of \$nil (2015 - \$nil) were declared and paid to the Bank's shareholders of common shares. The Bank paid dividends of \$778 on its preferred shares (2015 - \$670) during the year.

A general reserve of \$1,000 was established by the directors at January 31, 1995. Over time, this reserve has been increased to \$10,000 through transfers from retained earnings. Transfers back to retained earnings from the general reserve can be made at the discretion of the Board of Directors.

In 2016 the Bank's parent company, Clarien Group Limited, contributed a further \$12,600 in cash into the Bank as contributed surplus. The movement in contributed surplus in 2015 represented a \$1,250 payment to the shareholder.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***16. Net interest income**

Interest income is comprised of:	<u>2016</u>	<u>2015</u>
Loans and advances	\$ 51,977	\$ 54,393
Available for sale investments	1,753	1,335
Other interest income	<u>85</u>	<u>75</u>
Total interest income	<u>\$ 53,815</u>	<u>\$ 55,803</u>
Interest expense is comprised of:		
Customer accounts	<u>\$ 10,799</u>	<u>\$ 10,758</u>
Total interest expense	<u>\$ 10,799</u>	<u>\$ 10,758</u>

**17. Net fee and commission income**

Fee income is comprised of:	<u>2016</u>	<u>2015</u>
Investment Management	\$ 6,296	\$ 6,291
Banking	5,239	5,200
Brokerage	664	501
Trust	624	579
Advisory	241	368
Other	<u>671</u>	<u>677</u>
Total fee income	<u>\$ 13,735</u>	<u>\$ 13,616</u>
Fee expense is comprised of:		
Banking	\$ 2,506	\$ 2,308
Investment Management	676	517
Other	<u>216</u>	<u>241</u>
Total	<u>\$ 3,398</u>	<u>\$ 3,066</u>

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***18. Other expenses**

	<u>2016</u>	<u>2015</u>
Information technology expenses	\$ 4,134	\$ 5,198
Office expenses	2,003	2,078
Professional fees	1,988	1,906
Rent expenses	953	987
Advertising	831	1,094
Recruitment, training and travel	653	538
License and insurance costs	1,659	987
Bank charges	360	198
Directors' fees and expenses	366	446
Miscellaneous expenses	<u>1,078</u>	<u>1,456</u>
Total other expenses	<u>\$ 14,025</u>	<u>\$ 14,888</u>

**19. Pension expense**

The Bank's employees participate in a defined contribution pension plan sponsored by a company under common control. During the year ended December 31, 2016 contributions amounting to \$835 (2015 - \$885) equating to the service cost for the year, were made to the plan by the Bank on behalf of its employees and are included in personnel expenses in the consolidated statement of comprehensive income.

Included in these contributions made during the year ended December 31, 2016, were contributions amounting to \$144 (2015 - \$141), which were made by the Bank on behalf of its key management personnel.

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***20. Commitments, guarantees and contingent liabilities****Credit commitments**

In the normal course of business the Bank enters into commitments to meet the credit requirements of its customers. These credit arrangements, representing undertakings to make credit available in the form of new loans and mortgages and drawdown facilities (excluding credit-card commitments), are subject to the Bank's normal credit standards, controls and collateral requirements. The values set out in the table below represent the maximum amount of additional credit that the Bank could be obligated to extend, should such contracts be fully utilized.

	<u>2016</u>	<u>2015</u>
Commitments to extend credit:		
Original term to maturity of one year or less	\$ 9,565	\$ 3,574
Original term to maturity of more than one year	<u>8,315</u>	<u>4,353</u>
Total credit commitments	<u>\$ 17,880</u>	<u>\$ 7,927</u>

**Guarantees**

The Bank issues letters of credit and guarantees at the request of customers in order to secure the customer's payment or performance obligations to a third party. These guarantees represent an irrevocable obligation of the Bank to pay the third party beneficiary upon presentation of the guarantee and satisfaction of the documentary requirements stipulated therein. The Bank is contingently liable for customer letters of credit and guarantees amounting to \$1,521 (2015 - \$1,751). Of this amount, \$871 (2015 - \$1,101), is supported by collateral, which may include cash, securities, and other assets pledged.

The Bank has issued a guarantee to the Bermuda Stock Exchange on behalf of Clarien BSX Services Limited in the amount of \$650 (2015 - \$650).

The remaining terms of all guarantees and letters of credit range from 1 month to 12 months (2015 - 1 month to 16 months).

December 31, 2016

*(Expressed in thousands of Bermuda dollars, except as noted)***20. Commitments, guarantees and contingent liabilities** (continued)**Lease commitments**

The Bank has obligations under operating leases for three buildings that expire on December 31, 2018, January 31, 2023 and on February 3, 2033, respectively.

Leases typically run for a period of up to 20 years, with an option to renew the lease after that period. Lease payments can be adjusted based on either market values, or the movement in the consumer price index. Future minimum lease payments under the non-cancellable operating leases are as follows:

<u>Fiscal Year</u>	<u>2016</u>	<u>2015</u>
2016	\$ -	\$ 952
2017	952	952
2018	952	952
2019	822	822
2020	822	822
2021	822	822
Thereafter	<u>1,104</u>	<u>1,104</u>
	<u>\$ 5,474</u>	<u>\$ 6,426</u>

**Legal Proceedings**

In the normal course of business, the Bank is routinely engaged in a number of pending and threatened legal proceedings. Management does not expect the ultimate resolution of any threatened or actual legal proceedings involving the Bank, to have a material adverse effect on the consolidated financial statements.

**Other commitments**

As at December 31, 2016, the Bank has contractually committed to incur costs for I.T. systems of \$2,801 (2015 - \$2,770) within one year and \$1,972 (2015 - \$1,927) after more than one year.

**21. Seasonality of the Bank's transactions**

Given the activities in which the Bank and its subsidiaries engage, their transactions are not cyclical or seasonal in nature. Accordingly, no specific disclosures are provided in these explanatory notes to the consolidated financial statements for the year ended December 31, 2016 (2015: No specific disclosures).

**22. Comparative Information**

Certain prior-year figures have been restated to conform to current year presentation.



## Clarien Bank Limited

### Principal Offices and Subsidiaries

#### Registered Office

25 Reid Street  
Hamilton HM 11  
Bermuda

#### Main Branch

19 Reid Street  
Hamilton HM 11

#### Paget Plaza

161 South Road  
Paget DV04

#### Clarien Investments Limited

25 Reid Street  
Hamilton HM 11

#### Clarien Trust Limited

19 Reid Street  
Hamilton HM 11

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