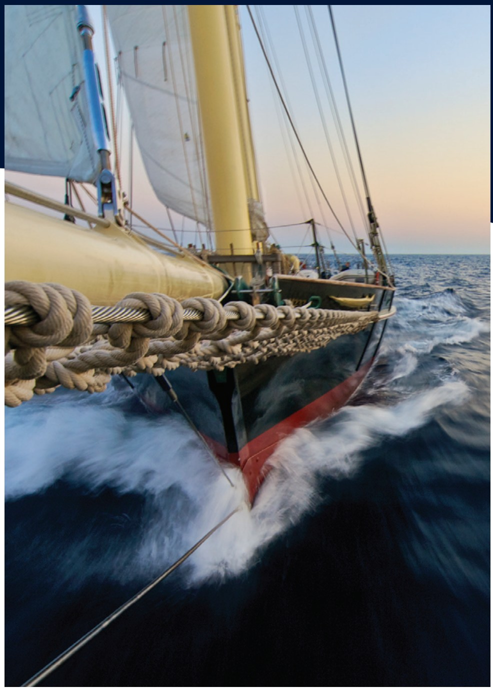
Clarien Bank Limited

Consolidated Financial Statements
(With Independent Auditors' Report Thereon)

For the nine months ended September 30, 2018



CLARIEN

Table of Contents

CLARIEN

Independent auditor's report

To the Board of Directors and Shareholders of Clarien Bank Limited

Our opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of Clarien Bank Limited (the Company) and its subsidiaries (together 'the Group') as at September 30, 2018, and their consolidated financial performance and their consolidated cash flows for the nine months ended September 30, 2018 in accordance with International Financial Reporting Standards.

What we have audited

The Group's consolidated financial statements comprise:

- the consolidated statement of financial position as at September 30, 2018;
- the consolidated statement of comprehensive income for the nine months ended September 30, 2018;
- the consolidated statement of changes in equity for the nine months ended September 30, 2018;
- the consolidated statement of cash flows for the nine months ended September 30, 2018; and
- the notes to the consolidated financial statements, which include a summary of significant accounting policies.

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 believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Independence

We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (IESBA Code) and the ethical requirements of the Chartered Professional Accountants of Bermuda Rules of Professional Conduct (CPA Bermuda Rules) that are relevant to our audit of the consolidated financial statements in Bermuda. We have fulfilled our other ethical responsibilities in accordance with the IESBA Code and the ethical requirements of the CPA Bermuda Rules.

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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 International Financial Reporting Standards, 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 to 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 scepticism 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.

PricewaterhouseCoopers Ltd.

Chartered Professional Accountants

Hamilton, Bermuda

December 20, 2018

(Expressed in thousands of Bermuda dollars)

	Note(s)	September 30, 2018	December 31, 2017
Assets			
Cash and cash equivalents	5	$ 168,420	$ 221,045
Investment securities	6	310,972	180,889
Accounts receivable and prepaid expenses	7	5,374	3,929
Accrued interest on cash, deposits with banks and securities		1,893	914
Loans and advances	8,13	735,956	745,051
Due from related parties	13	1,082	1,303
Investment property	9	3,377	3,477
Property and equipment	10	14,578	15,660
Intangible assets	11	18,947	20,674
Total assets		$ 1,260,599	$ 1,192,942
Liabilities			
Due to depositors	12,13	$ 1,134,582	$ 1,074,843
Accounts payable and accrued liabilities	14	3,678	3,854
Due to clients		1,653	160
Deferred income		336	108
Total liabilities		1,140,249	1,078,965
Equity			
Common shares	15	5,000	5,000
Contributed surplus	15	46,406	46,406
General reserve	15	10,000	10,000
Retained earnings		63,624	54,762
Accumulated other comprehensive loss		(4,680)	(2,191)
Total equity		120,350	113,977
Total liabilities and equity		$ 1,260,599	$ 1,192,942

See accompanying notes to consolidated financial statements

Signed on behalf of the Board

____________________ Director

____________________ Director

(Expressed in thousands of Bermuda dollars)

	Note(s)	September 30, 2018	December 31, 2017
Interest income	16	$ 44,321	$ 55,534
Interest expense	16	(10,043)	(11,193)
Net interest income		34,278	44,341
Fee and commission income	17	12,281	15,367
Fee and commission expense	17	(3,383)	(3,789)
Net fee and commission income		8,898	11,578
Net gains / (losses) on investment securities	6	135	(59)
Foreign exchange income		504	462
Rent		268	357
Revenue		44,083	56,679
Credit impairment losses	8	2,530	6,046
Net operating income		41,553	50,633
Personnel expenses	13,19	20,133	27,332
Depreciation and amortisation	9,10,11	3,546	4,552
Other expenses	13,18	10,546	14,860
Total other expenses		34,225	46,744
Profit for the period		$ 7,328	$ 3,889
Other comprehensive loss			
Items that may be reclassified subsequently to profit or loss:			
Net change in unrealized losses on securities designated as fair value through other comprehensive income		$ (2,354)	$ (180)
Reclassification to earnings of net realized (gains) / losses in the period		(135)	59
Other comprehensive loss for the period		(2,489)	(121)
Total comprehensive income for the period		$ 4,839	$ 3,768

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

(Expressed in thousands of Bermuda dollars)

	Note	Common shares	Contributed surplus	General reserve	Retained earnings	Accumulated other comprehensive loss	Total
Balance at January 1, 2018		$ 5,000	$ 46,406	$ 10,000	$ 54,762	$ (2,191)	$ 113,977
Changes on initial application of IFRS 9	3	-	-	-	1,534	-	1,534
Restated balance at January 1, 2018		$ 5,000	$ 46,406	$ 10,000	$ 56,296	$ (2,191)	$ 115,511
Total comprehensive income for the period							
Profit for the period		-	-	-	7,328	-	7,328
Total other comprehensive loss		-	-	-	-	(2,489)	(2,489)
Total comprehensive loss for the period, net of tax		-	-	-	7,328	(2,489)	4,839
Balance at September 30, 2018		$ 5,000	$ 46,406	$ 10,000	$ 63,624	$ (4,680)	$ 120,350

See accompanying notes to consolidated financial statements

(Expressed in thousands of Bermuda dollars)

	Note	Preferred shares	Common shares	Contributed surplus	General reserve	Retained earnings	Accumulated other comprehensive loss	Total
Balance at January 1, 2017		$ 20,000	$ 5,000	$ 22,150	$ 10,000	$ 51,703	$ (2,070)	$ 106,783
Total comprehensive income for the year								
Profit for the year		–	–	–	–	3,889	–	3,889
Total other comprehensive loss		–	–	–	–	–	(121)	(121)
Total comprehensive loss for the year, net of tax		–	–	–	–	3,889	(121)	3,768
Capital contribution	15	–	–	24,256	–	–	–	24,256
Redemption of preference shares	15	(20,000)	–	–	–	–	–	(20,000)
Preferred share dividends declared	15	–	–	–	–	(830)	–	(830)
Balance at December 31, 2017		$ –	$ 5,000	$ 46,406	$ 10,000	$ 54,762	$ (2,191)	$ 113,977

See accompanying notes to consolidated financial statements

(Expressed in thousands of Bermuda dollars)

	Note	September 30, 2018	December 31, 2017
Cash flows from operating activities			
Profit for the period		$ 7,328	$ 3,889
Adjustments to reconcile profit for the period to net cash provided by operating activities:			
Depreciation and amortization		3,546	4,552
Amortization of premiums / discounts on fixed income securities		(4)	491
Net (gains) / losses on investment securities		(135)	59
Net impairment loss on financial assets		2,530	6,046
Net changes in non-cash balances relating to operations:			
Change in accounts receivable and prepaid expenses		(1,445)	12
Change in accrued interest on cash, deposits with banks and securities		(979)	(231)
Change in loans and advances		8,098	5,278
Change in due from related parties		221	6,436
Change in due to depositors		59,739	21,145
Change in accounts payable and accrued liabilities		(176)	233
Change in due to clients		1,493	(106)
Change in deferred income		228	24
Net cash provided by operating activities		80,444	47,828
Cash flows from investing activities			
Acquisition / reinvestment of available-for-sale securities		(238,508)	(113,823)
Proceeds / maturity of available-for-sale securities		106,076	93,896
Intangible assets acquired	11	(472)	(2,017)
Property and equipment purchased	10	(165)	(524)
Net cash used in investing activities		(133,069)	(22,468)
Cash flows from financing activities			
Preferred share dividends paid	15	-	(830)
Redemption of preference shares	15	-	(20,000)
Capital contribution	15	-	24,256
Net cash provided by financing activities		-	3,426
Net (decrease) / increase in cash and cash equivalents		(52,625)	28,786
Cash and cash equivalents, beginning of period		221,045	192,259
Cash and cash equivalents, end of period	5	$ 168,420	$ 221,045
Cash flows from operating activities includes:			
Interest paid		$ 9,609	$ 9,001
Interest received		42,326	52,780

See accompanying notes to consolidated financial statements

(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"). The Bank changed its name from CAPITAL G Bank Limited to Clarien Bank Limited effective April 17, 2014. The Bank is wholly owned subsidiary of Clarien Group Limited ("Clarien").

On December 13, 2017, Clarien announced that it had entered into a formal agreement with NCB Financial Group Ltd ("NCB") whereby NCB became the majority shareholder of Clarien and therefore controlling shareholder of the Bank. Under the agreement, NCB subscribed for a 50.1% majority of the shares of Clarien. Funds managed by Portland Private Equity ("PPE") hold 17.92% stake in Clarien and Edmund Gibbons Limited ("EGL") retains a 31.98% shareholding. Both NCB and PPE are part of the Michael Lee-Chin controlled Portland group of companies.

During the period January 1, 2018 to September 30, 2018 (the "period"), the Bank changed its financial reporting date from December 31 to September 30 to align it with the financial reporting date of NCB. Accordingly, these financial statements present the results of operations and cash flows for the nine months ended September 30, 2018 with comparative figures for the year ended December 31, 2017.

The consolidated financial statements of Clarien Bank Limited 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"), and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC").

The consolidated financial statements were authorized for issuance by the Board of Directors on December 20, 2018.

(b) Basis of measurement

The consolidated financial statements have been prepared on the historical cost basis, except for certain financial 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 impairment of loans and advances, investment securities, intangible assets, investment property and provisions for liabilities.

3. Summary of significant accounting policies

The accounting policies set out below have been applied consistently by the Bank entities. Where new accounting policies have been adopted in the period ended September 30, 2018, they have been applied consistently for that period. Comparative information has not been restated and previous accounting policies apply as described.

(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 adopted IFRS 9 Financial Instruments ("IFRS 9") and IFRS 15 Revenue from Contracts with Customers ("IFRS 15") on January 1, 2018.

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

The adoption of these standards resulted in changes in accounting policies and adjustments to the amounts previously recognized in the financial statements. The Bank did not early adopt these standards in previous periods.

As permitted by the transitional provisions, the Bank elected not to restate comparative figures. Any adjustments to the carrying amounts of financial assets and liabilities at the date of transition were recognized in opening retained earnings of the current period.

Consequently, for notes disclosures, the consequential amendments to IFRS 7 disclosures have also only been applied to the current period. The comparative period notes disclosures repeat those disclosures made in the prior year.

i) IFRS 9 Financial Instruments

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 instruments are initially recognized on the trade date at which the Bank becomes a party to the contractual provisions of the instrument.

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.

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, and for financial assets, adjusted for any loss allowance.

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 the Bank’s non-performance risk.

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

i) IFRS 9 Financial Instruments (continued)

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.

Assets and long positions are measured at the current bid price, liabilities and short positions are measured at the ask price as at the reporting date. 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.

Classification and measurement of financial instruments

As required by IFRS 9, the Bank uses a principles-based approach to the classification of financial assets based on its business model and the nature of the cash flows of the asset. 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").

Debt instruments are measured at amortized cost if they are held for collection of contractual cash flows where those cash flows represent solely payments of principal and interest. Interest income from these financial assets is included in interest income using the effective interest rate method. Any gain or loss arising on derecognition is recognized directly in profit or loss together with foreign exchange gains or losses. Impairment losses are presented as a separate line item in the consolidated statement of comprehensive income.

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

i) IFRS 9 Financial Instruments (continued)

Debt instruments are measured at FVOCI if they are held for collection of contractual cash flows and for selling the financial assets, where the financial assets' cash flows represent payments of principal and interest. Movements in the carrying amount are taken through OCI, except for the recognition of impairment gains and losses, interest income and foreign exchange gains and losses which are recognised in profit or loss. When the financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss and recognised in net gains / (losses) on investment securities. Interest income from these financial assets is recognised in interest income using the effective interest rate method. Foreign exchange gains or losses are presented in foreign exchange income and impairment losses are presented as a separate line item in the consolidated statement of comprehensive income.

All other debt instruments are measured at FVPL. Equity instruments are measured at FVPL, unless the asset is not held for trading purposes and the Bank makes an irrevocable election to designate the asset as FVOCI. This election is made on an instrument-by-instrument basis.

Business model assessment

IFRS 9 requires an assessment of the nature of the Bank’s business model at a level that best reflects how it manages portfolios of financial assets. The Bank’s business models fall into two categories:

i) Held-to-Collect (“HTC”): where the objective of the business model is to solely collect the contractual cash flows from the assets.

ii) Held-to-Collect-and-Sell (“HTC&S”): where both collecting contractual cash flows and cash flows arising from the sale of assets are the objective of the business model.

Solely payments of principal and interest (“SPPI”) assessment

Instruments held within an HTC or HTC&S business model are assessed to evaluate if their contractual cash flows are SPPI. SPPI payments are those which would typically be expected from basic lending arrangements. Principal amounts include par repayments from lending and financing arrangements, and interest primarily relates to basic lending returns, including compensation for credit risk and the time value of money associated with the principal amount outstanding over a period of time. Interest can also include other basic lending risks and costs (for example, liquidity risk, servicing or administrative costs) associated with holding the financial asset for a period of time, and a profit margin.

Based on the above assessments, the Bank’s accounting treatment of each class of its financial instruments is as follows:

Cash and cash equivalents	Amortised cost
Loans and advances	Amortised cost
Investment securities (debt)	FVOCI / Amortised cost
Investment securities (equity)	FVOCI by election

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

i) IFRS 9 Financial Instruments (continued)

Loans

Loans are recognized initially at fair value and are subsequently measured in accordance with the classification of financial assets policy provided above. The Bank's loans are carried at amortized cost using the effective interest rate method, which represents the gross carrying amount less any allowance for credit losses.

Interest on loans is recognized in interest income using the effective interest method. The estimated future cash flows used in this calculation include those determined by the contractual term of the asset and all fees that are considered to be integral to the effective interest rate. Also included in this amount are transaction costs and all other premiums or discounts. Fees that relate to activities such as originating or renegotiating loans are deferred and recognized as interest income over the expected term of such loans using the effective interest method.

Allowance for credit losses

Under IFRS 9, credit loss allowances are measured on each reporting date according to a three-stage expected credit loss impairment model. Changes in the required credit loss allowance are recorded in profit or loss for the period as credit impairment losses.

An allowance for credit losses ("ACL") is established for all financial assets, except for financial assets classified or designated as FVTPL and equity securities designated as FVOCI, which are not subject to impairment assessment. Assets subject to impairment assessment include loans, debt securities, accounts receivable and accrued interest receivable. Loans are carried at amortized cost and presented net of ACL on the consolidated statement of financial position.

The Bank measures ACL at each reporting date according to a three-stage expected credit loss impairment model:

- Stage 1 – From initial recognition of a financial asset to the date on which the asset has experienced a significant increase in credit risk relative to its initial recognition, a loss allowance is recognized equal to the credit losses expected to result from defaults occurring over the 12 months following the reporting date.

- Stage 2 – Following a significant increase in credit risk relative to the initial recognition of the financial asset, a loss allowance is recognized equal to the credit losses expected over the remaining lifetime of the asset.

- Stage 3 – When a financial asset is considered to be credit-impaired, a loss allowance is recognized equal to credit losses expected over the remaining lifetime of the asset. Interest revenue is calculated based on the carrying amount of the asset, net of the loss allowance, rather than on its gross carrying amount.

The ACL is a discounted probability-weighted estimate of the cash shortfalls expected to result from defaults over the relevant time horizon.

Increases or decreases in the required ACL attributable to purchases and new originations, derecognitions or maturities, and remeasurements due to changes in loss expectations or stage migrations are recorded in credit impairment losses. Write-offs and recoveries of amounts previously written off are recorded against ACL.

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

i) IFRS 9 Financial Instruments (continued)

The ACL represents an unbiased estimate of expected credit losses on our financial assets as at the reporting date. Judgment is required in making assumptions and estimations when calculating the ACL, including movements between the three stages and the application of forward-looking information. The underlying assumptions and estimates may result in changes to the provisions from period to period that significantly affect our results of operations.

Measurement of expected credit losses

Expected credit losses are based on a range of possible outcomes and consider all available reasonable and supportable information including internal and external ratings, historical credit loss experience, and expectations about future cash flows. The measurement of expected credit losses is based primarily on the discounted product of the instrument's probability of default ("PD"), loss given default ("LGD"), and exposure at default ("EAD") defined as follows:

The PD represents the likelihood of a borrower defaulting on its financial obligation, either over the next 12 months or over the remaining lifetime of the obligation.

LGD represents the Bank's expectation of the extent of loss on a defaulted exposure. LGD varies by type of counterparty, type and seniority of claim and availability of collateral or other credit support. LGD is expressed as a percentage loss per unit of exposure at the time of default (EAD). LGD is calculated on a 12-month or lifetime basis, where 12-month LGD is the percentage of loss expected to be made if the default occurs in the next 12 months and lifetime LGD is the percentage of loss expected to be made if the default occurs over the remaining expected lifetime of the loan.

EAD is based on the amounts the Bank expects to be owed at the time of default, over the next 12 months or over the remaining lifetime.

Stage 1 estimates project PD, LGD and EAD over a maximum period of 12 months while Stage 2 estimates project PD, LGD and EAD over the remaining lifetime of the instrument. The 12 month and lifetime EADs are determined based on the expected payment profile, which varies by product type. For amortising products, this is based on the contractual repayments owed by the borrower over a 12 month or lifetime basis. This will also be adjusted for any expected overpayments made by a borrower. Early repayment / refinance assumptions are also incorporated into the calculation.

An expected credit loss estimate is produced for each individual exposure. Relevant parameters are modelled on a collective basis using portfolio segmentation that allows for appropriate incorporation of forward-looking information. To reflect other characteristics that are not already considered through modelling, expert credit judgment is exercised in determining the final expected credit losses.

For a small percentage of assets which lack detailed historical information and / or loss experience, the Bank applies simplified measurement approaches that may differ from what is described above. These approaches have been designed to maximize the available information that is reliable and supportable for each asset and may be collective in nature.

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

i) IFRS 9 Financial Instruments (continued)

Assessment of significant increase in credit risk

The assessment of significant increase in credit risk requires significant judgment. Movements between Stage 1 and Stage 2 are based on whether an instrument's credit risk at the reporting date has increased significantly relative to the date it was initially recognized. For the purposes of this assessment, credit risk is based on an instrument's lifetime PD, not the losses the Bank expects to incur.

The Bank's assessment of significant increases in credit risk is based on the assessment of the instrument's risk rating per the Bank's risk rating policy.

All loans receive an initial risk rating at origination. This is updated at regular intervals during the life of the loan based on factor's including days past due ("DPD"), performance and other known material changes. The portfolio as a whole is assessed for compliance with the policy on a monthly basis.

Ratings of individual loans are based on the following criteria:

- Credit structure and cash flow stability;
- Specific loan and collateral characteristics;
- Guarantees and other credit support;
- Macro-economic factors;
- Financial and management information for commercial loans.

This assessment results in a risk rating for each loan between 1 and 8, where a rating of 1-4 is considered "low risk", a rating of 5 "medium risk" and 6-8 "high risk".

The Bank considers loans that have missed a full payment cycle (more than 30 DPD) or are risk rated 6 or higher to have experienced a significant increase in credit risk. Renegotiated loans are also considered to have experienced a significant increase in credit risk, until they have successfully completed their cure period. The Bank assesses any other loans as having experienced a significant increase in credit risk if their risk rating has worsened by two or more points on the scale, relative to the rating at origination.

If any of these factors indicates that a significant increase in credit risk has occurred, the instrument is moved from Stage 1 to Stage 2

The thresholds for movement between Stage 1 and Stage 2 are symmetrical. After a financial asset has migrated to Stage 2, if its credit risk is no longer considered to have significantly increased relative to its initial recognition, the financial asset will move back to Stage 1.

Use of forward-looking information

The measurement of expected credit losses for each stage and the assessment of significant increase in credit risk considers information about past events and current conditions as well as reasonable and supportable projections of future events and economic conditions. The estimation and application of forward-looking information requires significant judgment.

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

i) IFRS 9 Financial Instruments (continued)

The PD, LGD and EAD inputs used to estimate Stage 1 and Stage 2 credit loss allowances are modelled based on the changes in macroeconomic variables that are most closely correlated with credit losses in the Bank's portfolio. Each macroeconomic scenario used in the Bank's expected credit loss calculation includes a projection of all relevant macroeconomic variables used in the Bank's models for the lifetime of the asset. Macroeconomic variables used in the Bank's expected credit loss models include, but are not limited to, unemployment rates, collateral normalization rates and interest rates. The impact of these economic variables has been determined by performing statistical analysis to understand that a correlation exists between certain variables, mainly default rates. The PD is impacted by changes in unemployment rate data gathered from an external rating agency. Collateral normailsation rate changes impact the LGD and interest rates estimations will impact future year balances in the calculation of ECL. The economic variables used in the Bank's model are regularly updated. The impact of any reasonably possible fluctuations in these variables is considered by management to be immaterial.

The Bank's estimation of expected credit losses in Stage 1 and Stage 2 is a discounted probability-weighted estimate that considers a minimum of three future macroeconomic scenarios. The base case scenario is based on 30 year macroeconomic forecasts published by a major rating agency. Stronger and weaker near-term scenarios vary relative to the base case scenario based on reasonably possible alternative macroeconomic conditions. Scenario selection, including the consideration of additional downside scenarios, occurs at least on a quarterly basis and more frequently if conditions warrant. Scenarios are weighted at 60% for the base line, 25% for stronger near term recovery and 15% for slower near term rebound.

Scenarios are designed to capture a wide range of possible outcomes and weighted according to the Bank's best estimate of the relative likelihood of the range of outcomes that each scenario represents. Scenario weights take into account historical frequency, current trends, and forward-looking conditions and are updated on a quarterly basis. The assessment of significant increases in credit risk is based on changes in borrower circumstances, both current and from origination, or where instruments have missed a full payment cycle or are in a cure period following renegotiation.

Definition of default

The definition of default used in the measurement of expected credit losses is consistent with the definition of default used for the Bank's internal credit risk management purposes. The definition of default may differ across products and considers both quantitative and qualitative factors, such as the terms of financial covenants and days past due. Default occurs when the borrower is 90 days past due on any obligation, and / or the Bank considers the borrower unlikely to make its payments in full without recourse action on its part, such as taking formal possession of any collateral held. The definition of default used is applied consistently from period to period and to all financial instruments unless it can be demonstrated that circumstances have changed such that another definition of default is more appropriate.

Credit-impaired financial assets (Stage 3)

Financial assets are assessed for credit-impairment quarterly and more frequently when circumstances warrant further assessment. Evidence of credit-impairment may include indications that the borrower is experiencing significant financial difficulty, probability of bankruptcy or other financial reorganization, as well as a measurable decrease in the estimated future cash flows evidenced by the adverse changes in the payment status of the borrower or economic conditions that correlate with defaults. An asset that is in Stage 3 will move back to Stage 2 when, as at the reporting date, it is no longer considered to be credit-impaired. The asset will migrate back to Stage 1 when its credit risk at the reporting date is no longer considered to have increased significantly from initial recognition, which could occur during the same reporting period as the migration from Stage 3 to Stage 2.

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

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

i) IFRS 9 Financial Instruments (continued)

When a financial asset has been identified as credit-impaired, expected credit losses are measured as the difference between the asset's gross carrying amount and the present value of estimated future cash flows discounted at the instrument's original effective interest rate.

When a financial asset is credit-impaired, interest ceases to be recognized on the regular accrual basis, which accrues income based on the gross carrying amount of the asset. Rather, interest income is calculated by applying the original effective interest rate to the amortized cost of the asset, which is the gross carrying amount less the related ACL. Following impairment, interest income is recognized on the unwinding of the discount from the initial recognition of impairment. ACL for credit-impaired loans in Stage 3 are established at the borrower level, where losses related to impaired loans are identified on individual loans.

The following table contains an analysis of the credit risk exposure of financial assets for which an ACL is recognised. The gross carrying amount of the financial assets below represents the Bank's maximum exposure to credit risk on these assets as at September 30, 2018.

	Stage 1	Stage 2	Stage3	Total
Low Risk (Risk rating 1-4)	615,628	6,694	1,201	623,523
Medium Risk (Risk rating 5)	33,989	9,803	1,649	45,441
High Risk (Risk rating 6-8)	-	-	98,284	98,284
Gross carrying amount	649,617	16,497	101,134	767,248
Allowance for credit impairment loss	(1,092)	(138)	(30,062)	(31,292)
Carrying amount	648,525	16,359	71,072	735,956

Individually assessed loans (Stage 3)

When individually significant loans are identified as impaired, the Bank reduces the carrying value of the loans to their estimated realizable value by recording an individually assessed ACL to cover identified credit losses. The individually assessed ACL reflects the expected amount of principal and interest calculated under the terms of the original loan agreement that will not be recovered, and the impact of time delays in collecting principal and/or interest (time value of money). The estimated realizable value for each individual loan is the present value of expected future cash flows discounted using the original effective interest rate for each loan. When the amounts and timing of future cash flows cannot be estimated with reasonable reliability, the estimated realizable amount may be determined using observable market prices for comparable loans, the fair value of collateral underlying the loans, and other reasonable and supported methods based on management judgment.

Individually-assessed allowances are established in consideration of a range of possible outcomes, which may include macroeconomic or non-macroeconomic scenarios, to the extent relevant to the circumstances of the specific borrower being assessed. Assumptions used in estimating expected future cash flows reflect current and expected future economic conditions and are generally consistent with those used in Stage 1 and Stage 2 measurement.

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

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

i) IFRS 9 Financial Instruments (continued)

Significant judgment is required in assessing evidence of credit impairment and estimation of the amount and timing of future cash flows when determining expected credit losses. Changes in the amount expected to be recovered would have a direct impact on the provision for credit losses and may result in a change in the ACL.

Write-off of loans

Loans and the related ACL are written off, either partially or in full, when there is no realistic prospect of recovery, as determined by management. Where loans are secured, they are generally written off after receipt of any proceeds from the realization of collateral. In circumstances where the net realizable value of any collateral has been determined and there is no reasonable expectation of further recovery, write off may be earlier. For credit cards, the balances and related ACL are generally written off when payment is 180 days past due.

Impact of adoption of IFRS 9

Mandatory reclassifications

The combined application of the business model and SPPI tests on adoption of IFRS 9 resulted in the reclassification of the following financial assets and liabilities.

		January 1, 2018 IFRS 9		December 31, 2017 IAS 39
Investment securities (debt)	FVOCI	180,194	Available-for-sale	180,194
Investment securities (equity)	FVOCI	638	Available-for-sale	638
Investment securities (debt)	Amortised cost	57	Loans and receivables	57
Loans and advances	Amortised cost	746,585	Loans and receivables	745,051

Allowance for credit losses

The impact on the opening balance of the Bank's equity on adoption of IFRS 9 on January 1, 2018, due to the calculation of impairment allowances in accordance with the new standard was a $1,534 increase.

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

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

(b) *New standards* (continued)

i) IFRS 9 Financial Instruments (continued)

Consolidated balance sheets

The table below provides the reconciliation from IAS 39 to IFRS 9 for the consolidated balance sheet. There is no impact to the opening balance sheet of the comparative period, January 1, 2017.

	December 31, 2017 IAS 39	Impact of adoption of IFRS 9	January 1, 2018 IFRS 9
Assets			
Cash and cash equivalents	$ 221,045	$ -	$ 221,045
Investment securities	180,889	-	180,889
Accounts receivable and prepaid expenses	3,929	-	3,929
Accrued interest on cash, deposits with banks and securities	914	-	914
Loans and advances	745,051	1,534	746,585
Due from related parties	1,303	-	1,303
Investment property	3,477	-	3,477
Property and equipment	15,660	-	15,660
Intangible assets	20,674	-	20,674
Total assets	**$** 1,192,942	$ 1,534	$ 1,194,476
Liabilities			
Due to depositors	$ 1,074,843	$ -	$ 1,074,843
Accounts payable and accrued liabilities	3,854	-	3,854
Due to clients	160	-	160
Deferred income	108	-	108
Total liabilities	1,078,965	-	1,078,965
Equity			
Common shares	5,000	-	5,000
Contributed surplus	46,406	-	46,406
General reserve	10,000	-	10,000
Retained earnings	54,762	1,534	56,296
Accumulated other comprehensive loss	(2,191)	-	(2,191)
Total equity	113,977	1,534	115,511
Total liabilities and equity	$ 1,192,942	$ 1,534	$ 1,194,476

3. Summary of significant accounting policies (continued)

(b) New standards (continued)

ii) IFRS 15 Revenue from Contracts with Customers

The Bank adopted the provisions of IFRS 15 Revenue from Contracts with Customers ("IFRS 15") on January 1, 2018.

IFRS 15 specifies how and when an entity will recognise revenue as well as providing a single, principles based five-step model to be applied to all contracts with customers. The standard establishes the principles that an entity shall apply to report useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from a contract with a customer. The core principle is that an entity recognises revenue to reflect the transfer of good and services, measured as the amount the entity expects to be entitled in exchange for those goods and services. The recognition of such revenue is in accordance with five steps to: identify the contract; identify the performance obligations; determine the transactions price; allocate the transaction price to the performance obligations; and recognize revenue when the performance obligations are satisfied. The Bank has applied IFRS 15 using the cumulative effect method and therefore the comparative information has not been restated.

The Bank has assessed its contracts with customers and recognises revenue in line with the performance obligations of these contracts, either on a transaction by transaction basis or over the period of the contract.

The Bank's key revenue streams that are accounted for under the standard include investment management income, card fee income, miscellaneous fee income and customer account fee income. The performance obligations for these revenue streams are satisfied as the services are provided which is when revenue is recognized.

Certain credit card customers may enter loyalty programmes and earn cashback or points which are redeemable to purchase goods available as part of this programme. The cashback award is recongized as a reduction of the revenue. With respect to the points rewards, the Bank is acting as an agent and as such the revenue is recognised net of expenses once the points have been issued.

Interest income and fees which are an integral part of the effective interest rate are accounted for under the provisions of IFRS 9.

The provisions of IFRS 15 have had no significant effect on the consolidated financial statements.

(c) New standards and interpretations not yet adopted

One new standard is effective for annual periods beginning after January 1, 2019, with early adoption permitted. The Bank has not applied the following new standard in preparing these consolidated financial statements.

(iii) IFRS 16 Leases

IFRS 16 will result in almost all leases being recognized on the balance sheet by lessees, as the distinction between operating and finance leases is removed. Under the new standard, an asset (the right to use the leased item) and a financial liability to pay rentals are recognized. The only exceptions are short-term and low-value leases. 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.

3. Summary of significant accounting policies (continued)

(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.

(e) Cash and cash equivalents

Cash and cash equivalents consists of cash on hand, cash deposists held with financial institutions, 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.

(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) 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.

3. Summary of significant accounting policies (continued)

(h) 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.

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 the consolidated statement of comprehensive income.

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 the consolidated statement of comprehensive income 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.

(i) Investment property

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.

3. Summary of significant accounting policies (continued)

(i) Investment property (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

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

(j) 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.

(k) 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

3. Summary of significant accounting policies (continued)

(k) Impairment of non-financial assets (continued)

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.

(l) 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 rate of the financial assets or financial liabilities to which they relate. Any income which forms part of the effective interest rate of a financial instrument is recognized as an adjustment to the effective interest rate. 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.

(m) 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 earned from the provision of services is recognized as the services are provided, this includes the investment and trust management fees. Fee and commission income earned on completion of a significant act is recognized as revenue as the services are completed.

(n) Comprehensive income

The consolidated statement of comprehensive income reflects changes in accumulated OCI, comprised of changes in unrealized gains and losses on financial assets classified as FVOCI.

(o) 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.

(p) 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.

3. Summary of significant accounting policies (continued)

(q) 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.

(r) Employee benefits

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.

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.

Reduced rate employee loans are financial assets and under IFRS 9 (and IAS 39 in the year ended December 31, 2017), 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 reimbursement 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.

(s) 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.

(t) Accounting policies applied until December 31, 2017

The Bank has applied IFRS 9 and IFRS 15 retrospectively, but has elected not to restate comparative information. As a result, the comparative information provided continues to be accounted for in accordance with the Bank's previous accounting policy.

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.

3. Summary of significant accounting policies (continued)

(t) Accounting policies applied until December 31, 2017 (continued)

i) Financial assets and liabilities

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, renegotiation 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.

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 allowance 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 the consolidated statement of comprehensive income 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 the consolidated statement of comprehensive income. 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.

3. Summary of significant accounting policies (continued)

(t) Accounting policies applied until December 31, 2017 (continued)

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.

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 receivable.

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.

3. Summary of significant accounting policies (continued)

(t) Accounting policies applied until December 31, 2017 (continued)

Investment securities

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.

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.

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.

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.

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 are comprised of the appropriate mix of both independent and non-independent members and report regularly to the Board of Directors on their activities. The Board Committees are supported by management level committees, namely; the Executive Committee, the Credit Committee, the Asset and Liability Committee ("ALCO"), the Compliance Committee, the Operational Risk Committee and the New Products Committee. Each of these management level committees are directly responsible for defined areas of risk, developing related risk management policies and procedures and quarterly reporting to the Risk Committee.

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 90% (December 31, 2017 - 91%) 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 September 30, 2018 and December 31, 2017 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 20. 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).

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

4. Risk management (continued)

Credit risk (continued)

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 identify, manage, monitor and report 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.

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 stage and payment due status:

2018

		Performing		Impaired		
		Stage 1	Stage 2	Stage 3	Total	%
Current	$	623,006	11,351	3,602	637,959	83%
From 7 days up to 3 months		26,611	4,465	-	31,076	4%
3 to 6 months		-	681	5,581	6,262	1%
6 to 12 months		-	-	12,185	12,185	2%
Over 12 months		-	-	79,766	79,766	10%
Total		649,617	16,497	101,134	767,248	100%

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

4. Risk management (continued)

Credit risk (continued)

2017

Not impaired:		
Neither past due or impaired	$ 648,447	83%
Past due, but not individually impaired:		
From 7 days up to 3 months	25,140	3%
3 to 6 months	6,075	1%
6 to 12 months	4,054	1%
Over 12 months	18,981	2%
	54,250	7%
Individually impaired loans		
Up to 3 months	8,449	1%
3 to 6 months	4,120	1%
6 to 12 months	839	–
Over 12 months	62,365	8%
	75,773	10%
Total	$ 778,470	100%

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

Renegotiated loans are loans whose terms have been revised due to deterioration in the borrower's financial position. The Bank undertakes such renegotiations to maximize collection opportunities and minimize the risk of default. Upon renegotiating 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.

The risk of default of such assets after modification is assessed at the reporting date and compared with the risk under the original terms at initial recognition, when the modification is not substantial and so does not result in derecognition of the original asset. The Bank may determine that the credit risk has significantly improved after renegotiating, so that the assets are moved from Stage 3 or Stage 2 to Stage 1. This is only the case for assets which have performed in accordance with the new terms for six consecutive months or more.

For the period-ended September 30, 2018, loans amounting to $53,366 (December 31, 2017 - $61,213), that would otherwise be considered impaired based on the present value of collateral related cash flows only, have been renegotiated.

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.

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

4. Risk management (continued)

Credit risk (continued)

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:

	2018	2017
Past due but not impaired loans	$ 75,511	$ 58,709
Impaired loans	97,854	77,961
	$ 173,365	$ 136,670

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.

	2018		2017	
Concentration by credit grading				
AA	92,980	59%	174,504	82%
A	59,561	37%	30,513	15%
Other	5,815	4%	6,867	3%
	$ 158,356	100%	$ 211,884	100%
Concentration by region				
North America (including Bermuda)	$ 145,324	92%	$ 211,884	100%
Europe	13,032	8%	-	-
	$ 158,356	100%	$ 211,884	100%

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

4. Risk management (continued)

Credit risk (continued)

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

		2018			2017	
Concentration by credit grading						
AAA	$	66,366	21%	$	90,736	50%
AA		197,732	64%		62,503	35%
A		35,164	11%		26,955	15%
Other		11,710	4%		695	–
	$	310,972	100%		180,889	100%

		2018			2017	
Concentration by region						
North America (including Bermuda)	$	266,400	86%	$	161,163	89%
Europe		19,433	6%		9,970	6%
Australia		15,488	5%		-	-
Asia		9,651	3%		9,756	5%
	$	310,972	100%	$	180,889	100%

US Treasuries, which are rated AA are the largest portfolio holding at September 30, 2018. The remainder of the Bank's investment portfolio are holdings in sovereigns, supranational bonds and high grade corporates.

As at September 30, 2018, 100% (December 31, 2017 - 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 September 30, 2018 is $50 (December 31, 2017 - $57).

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.

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

4. Risk management (continued)

Liquidity risk (continued)

Contractual Cashflow analysis of financial liabilities

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 cash flow purposes. These are mostly foreign exchange spot transactions and are usually fully covered. This mismatch does not represent material market or liquidity risk
The table below details the Bank's financial liabilities based on liquidity.

September 30, 2018

	Carrying amount	Gross nominal inflow / (outflow)	Repayable on demand	Up to 3 months	3-6 months	6-12 months	1-5years	>5 years
Financial liabilities								
Due to depositors	$ 1,134,582	$ (1,148,905)	$ (673,327)	$ (116,827)	$ (83,322)	$ (164,772)	$ (110,657)	$ -
Accounts payable and accrued Liabilities	3,678	(3,678)	(3,678)	-	-	-	-	-
Due to clients	1,653	(1,653)	(1,653)	-	-	-	-	-
	$ 1,139,913	$ (1,154,236)	$ (678,658)	$ (116,827)	$ (83,322)	$ (164,772)	$ (110,657)	$ -
Unrecognized loan commitments	-	(16,593)	(3,428)	-	(2,590)	(1,130)	(6,656)	(2,789)
Financial guarantees and letters of credit	-	(1,216)	-	(176)	(890)	(150)	-	-
Total financial liabilities	$ 1,139,913	$ (1,172,045)	$ (682,086)	$ (117,003)	$ (86,802)	$ (166,052)	$ (117,313)	$ (2,789)

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

4. Risk management (continued)

Liquidity risk (continued)

December 31, 2017

	Carrying amount	Gross nominal inflow / (outflow)	Repayable on demand	Up to 3 months	3-6 months	6-12 months	1-5years	>5 years
Financial liabilities								
Due to depositors	$ 1,074,843	$ (1,082,582)	$ (517,094)	$ (259,187)	$ (80,029)	$ (147,612)	$ (78,660)	$ –
Accounts payable and accrued Liabilities	3,854	(3,854)	(3,854)	–	–	–	–	–
Due to clients	160	(160)	(160)	–	–	–	–	–
	$ 1,078,857	$ (1,086,596)	$ (521,108)	$ (259,187)	$ (80,029)	$ (147,612)	$ (78,660)	$ –
Unrecognized loan commitments	–	(29,906)	–	(7,536)	(16)	(686)	(19,681)	(1,987)
Financial guarantees and letters of credit	–	(1,391)	–	(890)	(325)	(176)	–	–
Total financial liabilities	$ 1,078,857	$ (1,117,893)	$ (521,108)	$ (267,613)	$ (80,370)	$ (148,474)	$ (98,341)	$ (1,987)

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.

<u>Interest rate risk</u>

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.

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.

<u>Interest Rate Sensitivity</u>

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 September 30, 2018. 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. The sensitivity analysis is consistent with the prior year.

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

4. Risk management (continued)

Market risk (continued)

September 30, 2018

		Impact to net interest income
100 basis point increase	$	562
200 basis point increase	$	989
100 basis point decrease	$	(3,715)
200 basis point decrease	$	(7,310)

December 31, 2017

		Impact to net interest income
100 basis point increase	$	1,224
200 basis point increase	$	2,453
100 basis point decrease	$	(4,491)
200 basis point decrease	$	(9,196)

The following tables summarize 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.

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

4. Risk management (continued)

Market risk (continued)

September 30, 2018 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	$ 168,420	$ 116,741	$ -	$ -	$ -	$ -	$ 51,679
Investment securities	310,972	24,954	-	34,621	230,745	20,012	640
Accounts receivable and prepaid expenses	5,374	-	-	-	-	-	5,374
Accrued interest on cash, deposits with banks and securities	1,893	-	-	-	-	-	1,893
Loans and advances	735,956	705,492	19,482	10,579	-	403	-
Due from related parties	1,082	-	-	-	-	-	1,082
Investment property	3,377	-	-	-	-	-	3,377
Property and equipment	14,578	-	-	-	-	-	14,578
Intangible assets	18,947	-	-	-	-	-	18,947
Total assets	1,260,599	847,187	19,482	45,200	230,745	20,415	97,570
Due to depositors	1,134,582	718,034	76,704	104,712	214,257	20,875	-
Accounts payable and accrued liabilities	3,678	-	-	-	-	-	3,678
Due to clients	1,653	-	-	-	-	-	1,653
Deferred income	336	-	-	-	-	-	336
Equity	120,350	-	-	-	-	-	120,350
Total liabilities and equity	1,260,599	718,034	76,704	104,712	214,257	20,875	126,017
Interest rate sensitivity gap	$ -	$ 129,153	$ (57,222)	$ (59,512)	$ 16,488	$ (460)	$ (28,447)
Cumulative interest rate sensitivity gap	$ -	$ 129,153	$ 71,931	$ 12,419	$ 28,908	$ 28,447	$ -

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

4. Risk management (continued)

Market risk (continued)

December 31, 2017 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	$221,045	$ 182,150	$ -	$ -	$ -	$ -	$ 38,895
Investment securities	180,889	23,083	17,957	12,927	120,258	6,026	638
Accounts receivable and prepaid expenses	3,929	–	–	–	–	–	3,929
Accrued interest on cash, deposits with banks and securities	914	–	–	–	–	–	914
Loans and advances	745,051	719,032	5,904	20,115	–	–	–
Due from related parties	1,303	–	–	–	–	–	1,303
Investment property	3,477	–	–	–	–	–	3,477
Property and equipment	15,660	–	–	–	–	–	15,660
Intangible assets	20,674	–	–	–	–	–	20,674
Total assets	1,192,942	924,265	23,861	33,041	120,258	6,026	85,491
Due to depositors	1,074,843	716,684	50,986	101,395	205,778	–	–
Accounts payable and accrued liabilities	3,854	–	–	–	–	–	3,854
Due to clients	160	–	–	–	–	–	160
Deferred income	108	–	–	–	–	–	108
Equity	113,977	–	–	–	–	–	113,977
Total liabilities and equity	1,192,942	716,684	50,986	101,395	205,778	–	118,099
Interest rate sensitivity gap	$ –	$ 207,557	$ (27,082)	$ (68,347)	$ (84,678)	$ 6,000	$ (33,450)
Cumulative interest rate sensitivity gap	$ –	$ 207,557	$ 180,475	$ 112,128	$ 27,450	$ 34,450	$ –

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.

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.

(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.

September 30, 2018

	Fair value through comprehensive income	Amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	$ -	$ 168,420	$ 168,420	$ 168,420
Investment securities	310,922	50	310,972	310,963
Loans and advances	-	735,956	735,956	735,673
Other assets	-	6,111	6,111	6,111
	$ 310,922	$ 910,537	$ 1,221,459	$ 1,221,167
Deposits	$ -	$ 1,134,582	$ 1,134,582	$ 1,129,858
Other liabilities	-	5,667	5,667	5,667
	$ -	$ 1,140,249	$ 1,140,249	$ 1,135,525

December 31, 2017

	Fair value through comprehensive income	Amortised cost	Total carrying amount	Fair value
Cash and cash equivalents	$ –	$ 221,045	$ 221,045	$ 221,045
Investment securities	180,832	57	180,889	180,889
Loans and advances	–	745,051	745,051	746,150
Other assets	–	5,176	5,176	5,176
	$ 180,832	$ 971,329	$ 1,152,161	$ 1,153,260
Deposits	$ –	$ 1,074,843	$ 1,074,843	$ 1,076,631
Other liabilities	–	4,122	4,122	4,122
	$ –	$ 1,078,965	$ 1,078,965	$ 1,080,753

(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. Instruments are valued using the most recent transaction price. 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.

	September 30, 2018			
	Level 1	Level 2	Level 3	Total
Financial Assets				
Investment securities				
US government and agency				
- Treasuries	$ 127,328	$ -	$ -	$127,328
- Agency debt	-	9,936	-	9,936
Other OECD government & government guaranteed and international organizations	-	92,647	-	92,647
Corporate debt securities	-	80,371	-	80,371
Equities	-	-	640	640
Total investment securities	**$127,328**	**$182,954**	**$640**	**$310,922**

(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, 2017			
	Level 1	Level 2	Level 3	Total
Financial Assets				
Securities - available-for-sale				
US government and agency				
- Treasuries	$ 49,510	$ –	$ –	$ 49,510
- Agency debt	–	9,960	–	9,960
Other OECD government & government guaranteed and international organizations	–	102,678	–	102,678
Corporate debt securities	–	18,046	–	18,046
Equities	–	-	638	638
Total available-for-sale securities	**$49,510**	**$130,684**	**$638**	**$180,832**

There were no significant transfers between Levels 1, 2 and 3 during the period ended September 30, 2018 (2017 - Nil).

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.

4. Risk management (continued)

Operational risk (continued)

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.

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 9.25% as at September 30, 2018, 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.

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

4. Risk management (continued)

Capital management (continued)

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).

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 September 30 was as follows.

	September 30, 2018	December 31, 2017
Tier 1 capital	$ 116,705	$ 109,142
Tier 2 capital	$ 1,092	$ 5,861
Total Tier 1 and 2 capital	$ 117,797	$ 115,003
Capital ratios		
Tier 1 capital	19.24%	18.72%
Total capital	19.42%	19.72%

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

5. Cash and cash equivalents

For the period ended:	September 30, 2018	December 31, 2017
Cash in hand	$ 10,063	$ 9,161
Cash at local banks	6,649	11,712
Cash at foreign banks	58,728	27,074
	$ 75,440	$ 47,947
Other cash equivalents	$ 92,980	$ 173,098
Total cash and cash equivalents	**$ 168,420**	**$ 221,045**

Cash at foreign banks of $58,728 (2017 - $27,074) includes $37,893 (2017 - $12,130) held in US dollars and $20,835 (2017 - $14,944) held in other foreign currencies. The average effective interest rate earned on cash and deposits with banks for the period ended September 30, 2018 was 0.25% (2017 - 0.12%).

Cash and deposits with banks includes $1,653 (2017 - $160) of restricted funds held in escrow on behalf of customers, and $5,048 (2017 - $5,030) pledged to collateralise standby letters of credit issued on behalf of customers.

As at September 30, 2018, foreign currency interest bearing deposits with banks of $57,816 includes $20,835 denominated in foreign currencies other than US dollar (2017: $23,557 included $14,944). As at September 30, 2018 and December 31, 2017, 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.

(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 September 30, 2018 and December 31, 2017.

No investment securities have been pledged (2017 - $0) as collateral to third parties.

The Bank's adoption of IFRS 9 on January 1, 2018 impacted the classification of investments as described in Note 3 *Summary of significant accounting policies*. The Bank has elected not to restate comparative information and therefore the comparative information in this note is accounted for in accordance with the Bank's previous accounting policy.

	September 30, 2018					
	Maturing Within 1 year	Maturing in 1 to 5 years	Maturing after 5 years	With no specific maturity	Carrying Amount	Fair value
FVOCI						
Fixed Income						
US government and agency						
- Treasuries	$ -	$ 113,036	$ 14,292	$ -	$ 127,328	$ 127,328
- Agency debt	9,936	-	-	-	9,936	9,936
Other OECD government & government guaranteed and international organizations	29,684	57,243	5,720	-	92,647	92,647
Corporate debt securities	-	74,711	5,660	-	80,371	80,371
Total – fixed income	39,620	244,990	25,672	-	310,282	310,282
Equities						
Equities	-	-	-	640	640	640
Total – FVOCI	**$ 39,620**	**244,990**	**25,672**	**640**	**310,922**	**310,922**
Debt securities measured at amortised cost						
Asset-backed securities	$ -	$ -	$ 50	$ -	$ 50	$ 41
Total investment securities	**$ 39,620**	**244,990**	**25,722**	**640**	**310,972**	**310,963**
Average effective interest rate	0.87%	2.25%	2.35%	- %	2.08%	

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

6. Investment securities (continued)

	December 31, 2017					
	Maturing Within 1 year	Maturing in 1 to 5 years	Maturing after 5 years	With no specific maturity	Carrying Amount	Fair value
Available-for-sale						
Fixed Income						
US government and agency						
- Treasuries	$ –	$ 49,509	$ –	$ –	$ 49,509	$ 49,509
- Agency debt	–	9,960	–	–	9,960	9,960
Other OECD government & government guaranteed and international organizations	45,877	50,776	6,026	–	102,679	102,679
Corporate debt securities	5,000	10,013	3,033	–	18,046	18,046
Total – fixed income	50,877	120,258	9,059	–	180,194	180,194
Equities						
Equities	–	–	–	638	638	638
Total – available-for-sale	**$ 50,877**	**$ 120,258**	**$ 9,059**	**$ 638**	**$ 180,832**	**$ 180,832**
Debt securities classified as loans and receivables						
Asset-backed securities	$ –	$ –	$ 57	$ –	$ 57	$ 57
Total investment securities	**$ 50,877**	**$ 120,258**	**$ 9,116**	**$ 638**	**$ 180,889**	**$ 180,889**
Average effective interest rate	0.94%	1.39%	2.55%	– %	1.32%	

(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 $50 and fair value totalling $41 (2017 - $57 and $57 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' ECLs to be material as at September 30, 2018.

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 / (losses) on investment securities are made up of net realized gains on sale of FVOCI securities of $135 for the period ended September 30, 2018 and losses on the sale of available-for-sale securities of $59 in the year ended December 31, 2017.

7. Accounts receivable and prepaid expenses

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

	September 30, 2018	December 31, 2017
In one year or less:		
Prepaid staff loan benefit	$ 404	$ 418
Management fees, trail commissions and custody fees receivable	1,985	1,895
Other prepaid expenses	2,205	976
Accounts receivable	344	301
	$ 4,938	$ 3,590
In more that one year:		
Prepaid staff loan benefit	403	331
Management fees, trail commissions and custody fees receivable	-	-
Other prepaid expenses	33	8
Accounts receivable	-	-
Total	$ 5,374	$ 3,929

(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:

	September 30, 2018	December 31, 2017
Residential mortgages	$ 590,735	$ 615,803
Commercial mortgages	98,525	93,627
Loans and advances - secured	70,657	61,111
Loans and advances - unsecured	1,264	1,673
Credit card receivables	6,067	6,256
	767,248	778,470
Allowance for credit losses on loans, mortgages and credit card receivables	(31,292)	(33,419)
	$ 735,956	$ 745,051

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

	September 30, 2018			December 31, 2017		
	Amortized cost		Fair value	Amortized cost		Fair value
Maturity analysis						
One year or less	$ 28,510	4%	$ 28,500	$ 25,547	3%	$ 25,772
More than one year	707,446	96%	707,173	719,504	97%	720,378
	$ 735,956	100%	735,673	$ 745,051	100%	$ 746,150

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.

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

8. **Loans and advances** (continued)

For the period ended September 30, 2018, the Bank had the following loans and advances assessed as Stage 3 ("impaired") under IFRS 9:

	September 30, 2018
Residential mortgages:	
Gross loans	$ 73,009
Stage 3 allowance	(20,617)
Net residential mortgages	52,392
Commercial mortgages:	
Gross loans	$ 20,173
Stage 3 allowance	(6,367)
Net commercial mortgages	13,806
Loans and chattel mortgages:	
Gross loans	7,952
Stage 3 allowance	(3,078)
Net loans and chattel mortgages	4,874
	$ 71,072

Loans past due but not impaired are as follows:

	September 30, 2018
From 7 days up to 3 months	$ 31,076
3 to 6 months	681
Total	$ 31,757

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

8. Loans and advances (continued)

For the year ended December 31, 2017, the Bank had the following loans and advances that are considered to be impaired:

		December 31, 2017
Residential and commercial mortgages:		
Gross loans	$	68,867
Specific allowance		(24,591)
Net mortgages		44,276
Loans and chattel mortgages:		
Gross loans		6,906
Specific allowance		(2,967)
Net loans and chattel mortgages		3,939
	$	48,215

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 (2017 - 30 years). At September 30, 2018 the weighted average time remaining to maturity for mortgages was 16 years (2017 - 16 years). At September 30, 2018 loans and chattel mortgages are repayable in monthly or periodic instalments generally over periods not exceeding 5 years (2017 - 6 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% (2017 - 12% to 22.75%) and are unsecured.

The average effective interest rate on total loans and mortgages receivable at September 30, 2018 is 6.74% (2017 - 6.43%).

Total loans include $80,826 (2017 - $74,942) denominated in US dollars.

At September 30, 2018 the Bank held repossessed collateral relating to impaired loans with a carrying value of $23,048 (2017 - $13,161). Where the Bank is unable to sell repossessed collateral, it will hold the assets until market conditions make a sale more likely and, if applicable, seek to rent the property in the intervening period.

At September 30, 2018, loans, mortgages and credit card receivables included $3,659 (2017 - $3,739) receivable from directors, and $42,049 (2017 - $47,850) 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 4.5% to 6.00% (2017 - 4.5% to 6.00%), 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.

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

8. Loans and advances (continued)

For the period ended September 30, 2018, the Bank had the following loans and advances as assessed by the Bank's internal risk rating policies described in Note 3:

	Stage 1	Stage 2	Stage3	Total
Loans outstanding at September 30, 2018				
Low Risk (Risk rating 1-4)	$ 614,773	$ 6,636	$ -	$ 621,409
Medium Risk (Risk rating 5)	33,752	9,723	1,191	44,666
High Risk (Risk rating 6-8)	-	-	69,881	69,881
Total	$ 648,525	$ 16,359	$ 71,072	$ 735,956

Allowance for credit losses

The Bank's application of IFRS 9 and its approach to the establishment of the allowance for credit losses is explained in Note 3 Summary of significant accounting policies. The allowance for credit losses is deducted from loans and advances in the consolidated statement of financial position.

For the period ended September 30, 2018, changes in the allowance for credit losses are comprised of the following:

	Stage 1	Stage 2	Stage 3	Total
Balance at January 1, 2018	$ 1,542	$ 952	$ 29,391	$ 31,885
Transfers:				
Transfers from Stage 1 to Stage 2	(18)	42	-	24
Transfers from Stage 1 to Stage 3	(110)	-	738	628
Transfers from Stage 2 to Stage 1	103	(370)	-	(267)
Transfers from Stage 2 to Stage 3	-	(371)	416	45
Transfers from Stage 3 to Stage 1	20	-	(487)	(467)
Transfers from Stage 3 to Stage 2	-	80	(461)	(381)
Changes in PDs / LGDs / EADs	(376)	(6)	4,337	3,955
Charge offs & write offs	-	-	(3,869)	(3,869)
Recoveries	-	-	746	746
Provision on new loans	59	-	-	59
Provision on paid off loans	(128)	(189)	(749)	(1,066)
Balance at September 30, 2018	$ 1,092	$ 138	$ 30,062	$ 31,292

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

8. Loans and advances (continued)

Changes in gross carrying amount are comprised of the following:

	Stage 1	Stage 2	Stage 3	Total
Balance at January 1, 2018	$ 641,333	$ 32,208	$ 104,929	$ 778,470
Transfers:				
Transfers from Stage 1 to Stage 2	(7,994)	7,994	-	-
Transfers from Stage 1 to Stage 3	(3,433)	-	3,433	-
Transfers from Stage 2 to Stage 1	20,145	(20,145)	-	-
Transfers from Stage 2 to Stage 3	-	(5,967)	5,967	-
Transfers from Stage 3 to Stage 1	5,090	-	(5,090)	-
Transfers from Stage 3 to Stage 2	-	2,997	(2,997)	-
Financial assets derecognised during the period	(64,582)	265	(2,182)	(66,499)
New financial assets originated	58,613	-	81	58,694
Changes in interest accrual	445	(855)	862	452
Charge offs & write offs	-	-	(3,869)	(3,869)
Balance at September 30, 2018	$ 649,617	$ 16,497	$ 101,134	$ 767,248

For the year ended December 31, 2017, changes in the allowance for credit losses, assessed under IAS 39 are comprised of the following:

	December 31, 2017
Specific allowances for impairment:	
Balance at January 1, 2017	$ 26,110
Impairment loss for the year:	
Charge for the year, net	5,811
Write-offs	(4,846)
Recoveries	483
Balance at December 31, 2017	27,558
Collective allowances for impairment:	
Balance at January 1, 2017	5,626
Impairment loss for the year:	
(Release) / charge for the year, net	235
Balance at December 31, 2017	5,861
	$ 33,419

Write-offs during the periods ended September 30, 2018 and December 31, 2017 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 “credit impairment losses” and subsequently written off as incurred.

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

9. Investment property

Cost		
At January 1, 2017	$	4,994
At December 31, 2017	$	4,994
At September 30, 2018	$	4,994
Amortization and impairment losses		
At January 1, 2017	$	1,383
Amortization for the year		134
At December 31, 2017	$	1,517
Amortization for the period	$	100
At September 30, 2018	$	1,617
Carrying value		
At December 31, 2017	$	3,477
At September 30, 2018	$	3,377

The fair value of investment property as at September 30, 2018 is $4,082 (2017 - $4,082), a Level 3 fair value measurement. Investment property consists of one property with a carrying value of $3,377 (2017 - $3,477). 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 September 30, 2018 for impairment and found the recoverable amount to be greater than the carrying value. In determining the recoverable amount an independent appraisal from a qualified, experienced third party valuer and value-in-use model was used. In accordance with an independent appraisal a discount factor of 7% (2017 - 7%) was applied to the value-in-use cash flow projections to determine the net present value.

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

10. Property and equipment

Property and equipment held by the Bank is as follows:

	Buildings	Furniture and fixtures	Computer hardware and equipment	Artwork	Leasehold improvements	Total
Cost						
Balance at January 1, 2017	13,604	6,091	15,536	606	12,113	47,950
Additions	–	149	375	–	–	524
Balance at December 31, 2017	13,604	6,240	15,911	606	12,113	48,474
Balance at January 1, 2018	13,604	6,240	15,911	606	12,113	48,474
Additions	–	48	117	–	–	165
Balance at September 30, 2018	13,604	6,288	16,028	606	12,113	48,639
Accumulated depreciation						
Balance at January 1, 2017	5,413	5,361	14,251	–	6,107	31,132
Depreciation charge for the year	345	252	453	–	632	1,682
Balance at December 31, 2017	5,758	5,613	14,704	–	6,739	32,814
Balance at January 1, 2018	5,758	5,613	14,704	–	6,739	32,814
Depreciation charge for the period	259	183	331		474	1,247
Balance at September 30, 2018	6,017	5,796	15,035	–	7,213	34,061
Carrying amounts						
Balance at December 31, 2017	$ 7,846	$ 627	$ 1,207	$ 606	$ 5,374	$ 15,660
Balance at September 30, 2018	$ 7,587	$ 492	$ 993	$ 606	$ 4,900	$ 14,578

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

11. Intangible assets

Intangible assets are as follows:

		Computer software		Goodwill		Total
Cost						
Balance at January 1, 2017	$	27,295	$	7,456	$	34,751
Additions		2,017		–		2,017
Balance at December 31, 2017	$	29,312	$	7,456	$	36,768
Balance at January 1, 2018	$	29,312	$	7,456	$	36,768
Additions		472		–		472
Balance at September 30, 2018	$	29,784	$	7,456	$	37,240
Accumulated amortization						
Balance at January 1, 2017	$	13,358	$	–	$	13,358
Amortization charge for the year		2,736		–		2,736
Balance at December 31, 2017	$	16,094	$	–	$	16,094
Balance at January 1, 2018	$	16,094	$	–	$	16,094
Amortization charge for the period		2,199				2,199
Balance at September 30, 2018	$	18,293	$	–	$	18,293
Carrying amounts						
Balance at December 31, 2017	$	13,218	$	7,456	$	20,674
Balance at September 30, 2018	$	11,491	$	7,456	$	18,947

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. The Bank's analysis date was changed in the period to align with the new financial reporting date of September 30. 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 impairment testing for intangible assets using the methodology described herein.

Goodwill is monitored by management at the CGU level as follows;

As at September 30, 2018

	Clarien Bank Limited	Clarien Investments Limited
Goodwill	$ 1,219	$ 6,237
Basis of recoverable amount	Value in use	Value in use
Key assumptions	Discount rate of 11.41%	Discount rate of 11.41%

The impairment test for the Bank's CGUs' 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 11.41%, being the Bank's estimated cost of capital, was used to determine the net present value of the estimated cash flows for all the Bank's CGUs.

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 CGUs to decline below the carrying amount.

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

12. Due to depositors

Total deposits include $428,295 (2017 - $390,958) denominated in US dollars and $33,806 (2017 - $15,719) denominated in other foreign currencies. In 2018, the average effective interest rate paid on demand deposits increased compared to 2017, reflecting the US Federal Reserve increase in the federal funds rate during the period ended September 30, 2018. The Bank has $nil (2017 - $148,701) 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 September 30:

	September 30, 2018		December 31, 2017	
	Average effective interest rate	Amount	Average effective interest rate	Amount
Demand	0.40%	$ 559,574	0.37%	$ 517,416
Up to 3 months	1.83%	185,936	1.09%	182,800
3 - 6 months	2.22%	104,210	1.37%	50,986
6 - 12 months	2.20%	141,081	2.15%	147,160
1 - 5 years	1.80%	126,879	2.20%	160,013
Total	1.20%	1,117,680	1.06%	1,058,375
Accrued interest		16,902		16,468
Total		$ 1,134,582		$1,074,843

13. Related party transactions and balances

Related parties include the parent entity, companies associated through significant influence, control or common control and directors and their affiliates.

All related party transactions are in the normal course of operations and are measured at the exchange amount.

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% (2017 - 5%).

The work force of the Bank included 17 key management employees in 2018 (2017 - 19). During the period ended September 30, 2018, salaries, benefits and directors fees totalling $3,498 (2017 - $4,812) were paid to key management employees of the Bank. In addition there are 8 (2017 - 9) directors who are considered key management personnel.

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

13. Related party transactions and balances (continued)

Consolidated Statement of Comprehensive Income

	September 30, 2018	December 31, 2017
Interest income	$ 1,709	$ 1,945
Interest expense	$ 633	$ 503
Fee and commission income	$ 2,847	$ 4,062
Personnel expenses	$ 4,036	$ 5,431
Other expenses	$ 1,829	$ 2,807
Rent	$ 259	$ 344

Included in other expenses are $271 (2017 - $363) paid to key management employees. Personnel expenses includes $3,227 (2017 - $4,449) paid to key management personnel. The remainder of other expenses relates to transactions with companies associated through significant influence. In the summary above, all fee and commission income, fee and commission expense, personnel expenses and rent relate to transactions with companies associated through significant influence.

During the period ended September 30, 2018, the Bank recharged $68 (2017 - $95) to companies associated through significant influence, representing portions of certain expenses provided by the Bank. Of this amount, $27 (2017 - $48) has been included in personnel expenses and $41 (2017 - $47) has been included in other expenses in the consolidated statement of comprehensive income.

Consolidated Statement of Financial Position

	September 30, 2018	December 31, 2017
Related party balances - Included in assets		
Loans and advances (Key management personnel)	$ 10,558	$ 14,907
Loans and advances (Entities with significant influence)	$ 21,561	$ 16,933
Loans and advances (Companies associated through significant influence)	$ -	$ 100
Accounts receivable and prepaid expenses (Companies associated through significant influence)	$ 140	$ 50
Due from related parties (Companies associated through significant influence)	$ 1,082	$ 1,303
Related party balance - Included in liabilities		
Due to depositors (Key management personnel)	$ 7,082	$ 8,928
Due to depositors (Companies associated through significant influence)	$ 92,832	$ 76,991
Accounts payable and accrued liabilities (Companies associated through significant influence)	$ 193	$ 52

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.

(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:

	September 30, 2018	December 31, 2017
Accounts payable	$ 520	$ 406
Accrued liabilities	2,120	2,296
Bonus payable	622	696
Foreign currency tax payable	218	299
Visa rewards payable	198	157
Total	$ 3,678	$ 3,854

15. General reserve, retained earnings and contributed surplus

The total authorized, issued and fully paid Bermuda dollar common share capital is 4,999,999 (2017 - 4,999,999) with a par value of $1 per share. Common shares carry no right to regular dividends. In December 2017, the Bank redeemed 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 period ended September 30, 2018, dividends of $nil (2017 - $nil) were declared and paid to the Bank's shareholders of common shares. The Bank paid dividends of $nil on its preferred shares (2017 - $830) during the period.

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.

On December 13, 2017, the Bank's parent company, Clarien Group Limited, contributed a further $26,281 of capital into the Bank as contributed surplus. $2,025 of transaction fees were paid from this contribution.

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

16. Net interest income

Interest income is comprised:

	September 30, 2018	December 31, 2017
Loans and advances	$ 39,047	$ 51,730
Investment securities	3,585	2,872
Cash equivalents	1,554	839
Other interest income	135	93
Total interest income	$ 44,321	$ 55,534

Interest expense is comprised of:

	September 30, 2018	December 31, 2017
Customer accounts	$ 10,043	$ 11,193
Total interest expense	$ 10,043	$ 11,193

17. Net fee and commission income

Fee income is comprised of:

	September 30, 2018	December 31, 2017
Investment Management	$ 4,825	$ 6,623
Banking	5,165	6,423
Brokerage	647	637
Trust	541	681
Advisory	400	334
Other	703	669
Total fee income	$ 12,281	$ 15,367

Fee expense is comprised of:

	September 30, 2018	December 31, 2017
Banking	$ 2,625	$ 2,766
Investment Management	546	746
Other	212	277
Total	$ 3,383	$ 3,789

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

18. Other expenses

	September 30, 2018	December 31, 2017
Information technology expenses	$ 2,406	$ 3,503
Office expenses	1,395	1,819
Professional fees	1,463	2,592
Rent expenses	763	957
Advertising	653	726
Recruitment, training and travel	711	707
License and insurance costs	1,537	2,446
Bank charges	386	481
Directors' fees and expenses	271	363
Miscellaneous expenses	961	1,266
Total other expenses	$ 10,546	$ 14,860

19. Pension expense

The Bank's employees participate in a defined contribution pension plan sponsored by a company associated through significant influence. During the period ended September 30, 2018, contributions amounting to $614 (2017 - $859) 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 period ended September 30, 2018, were contributions amounting to $107 (2017 - $171), which were made by the Bank on behalf of its key management personnel.

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.

	September 30, 2018	December 31, 2017
Commitments to extend credit:		
Original term to maturity of one year or less	$ 7,148	$ 8,239
Original term to maturity of more than one year	9,445	21,667
Total credit commitments	$ 16,593	$ 29,906

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

20. Commitments, guarantees and contingent liabilities (continued)

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 $1,216 (2017 - $1,391). Of this amount, $566 (2017 - $741), is supported by collateral, which may include cash, securities, and other assets pledged, depending on the arrangement. These guarantees are issued with similar terms and conditions to the Bank's loans.

The Bank has issued a guarantee to the Bermuda Stock Exchange on behalf of Clarien BSX Services Limited in the amount of $650 (2017 - $650).

The remaining terms of all guarantees and letters of credit range from 1 month to 9 months (2017 - 1 month to 12 months).

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:

Fiscal period ended	September 30, 2018	December 31, 2017
2018	$ -	$ 952
2019	923	822
2020	890	822
2021	890	822
2022	890	822
2023	311	88
Thereafter	199	193
	$ 4,103	$ 4,521

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 September 30, 2018, the Bank has contractually committed to incur costs for I.T. systems of $2,679 (2017 - $2,544) within one year and $5,031 (2017 - $1,016) 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 period ended September 30, 2018 (2017: No specific disclosures).

Clarien Bank Limited

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