# Fidelity Bank (Bahamas) Limited

# 2008

## ANNUAL REPORT

FIDELITY
30th ANNIVERSARY

FIDELITY
30th ANNIVERSARY

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# Financial Highlights

## SUMMARY OF RESULTS

| | 2008 ($000) | 2007 ($000) |
|---|---|---|
| Revenue | 13,923 | 11,936 |
| Expenses | 12,610 | 10,469 |
| Net Income | 1,313 | 1,467 |
| Assets | 272,491 | 223,649 |
| Capital | 32,969 | 32,803 |
| Return on assets | 0.5% | 0.8% |
| EPS | 5.0 cents | 5.0 cents |

## CAPITAL ADEQUACY

| | | |
|---|---|---|
| Tier 1[1] | 20.84% | 25.87% |
| Tier 1 & 2[2] | 22.57% | 28.08% |

[1] Minimum required 4%
[2] Minimum required 8%

# Board of Directors


Sir William C. Allen
Chairman


Anwer J. Sunderji


Alfred H. Stewart


Gregory H. J. Bethel


Walter A. Wells


Lenworth C. Smith


Dr. Franklin Walkine

# Chairman's Report

Sir William C. Allen
Chairman

In 2008 the Bahamian economy is estimated to have declined for the first time since the economic slippage in 2003 and 2004 as a consequence of a severe global economic deterioration brought on by the meltdown of the world's financial system. To our great fortune, the Bahamian financial system was insulated from this global meltdown primarily by the operation of Exchange Control, and despite the weakened economy our banking system remained strong. As the International Monetary Fund observed in its Staff Report on the Bahamas in May this year, "the domestic banks remain well capitalized."

As you would know from the endless reports on the international situation this is quite exceptional as many international banks the world over were obliged to engage in heavy recapitalization exercises and to seek considerable assistance from their Governments.

It was against the background of a historic global economic and financial crisis and its profound impact on The Bahamian economy that your Bank performed in 2008 and, having regard to the circumstances, it was a great performance. The Bank's assets increased by nearly 22 per cent over the previous year. Operating revenues increased by roughly $2 million; and the strategy of upgrading the Bank as an integral part of its restructuring was completed during the year.

I am pleased to say that the Bank is now well positioned to realize on the investments made in its restructuring, and its credentials as a dynamic and innovative institution are becoming well established.

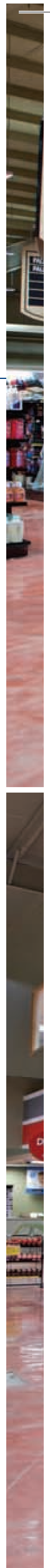
While we are likely to be faced with a continued weak economy through 2009, it is inevitable, however, that economic growth will again be restored. There are already signs at least in some industrial countries, including The United States, that the recession may indeed be bottoming. And there is an emerging consensus at this writing that a return to growth in 2010 is quite likely.

The Bank is well placed to successfully engage in this challenging economy and to ensure its own return to a robust growth path just as quickly as economic vibrancy is restored.

On behalf of The Board of Directors I should like once more to express our thanks to management and staff for another successful year.

William C. Allen

Sir William C. Allen
Chairman

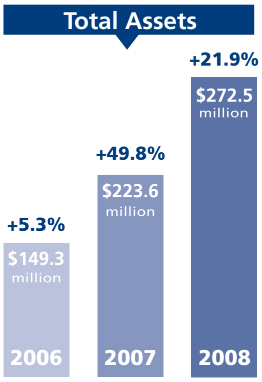


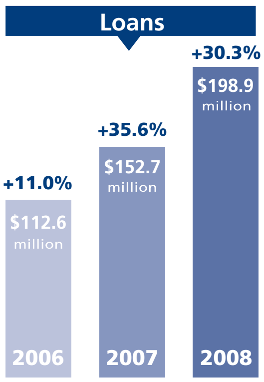


Money*Centre,* RobinHood

## Report from the
# Chief Executive Officer
Anwer J. Sunderji

2008 was an extraordinarily difficult year for global economies. The financial crisis arising from the US sub-prime mortgage debacle spread throughout the world, resulting in a sharp contraction in global economic activity. The Bahamas was not spared as its economy remains heavily dependent on the US. A decline in US consumer spending in early 2008 impacted The Bahamas tourism sector, resulting in significant layoffs towards the end of the year. As the fear of additional job losses percolated through the economy, the prospect of lower incomes prompted a significant reduction in the demand for domestic credit as well as signs of deterioration in asset quality.



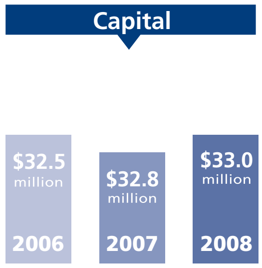

Despite this difficult economic climate, the Bank posted net income of $1.3 million, approximately 10% lower than the previous year. Assets grew by 22% to $272 million with loans growing by over 30% to $199 million. During 2008, the Bank suffered margin compression as cost of funds rose. Our significant growth in assets required us to issue high yielding Notes and compete more aggressively for deposits. Net interest income grew strongly by 19% or $1.43 million and non-interest income by 12% or $561,000. Total revenues grew by approximately 17%, or just under $2 million. However, non-interest expenses also increased by 20% or $2.1 million as a result of several initiatives begun in 2007 to grow the Bank. Expenses have now flattened as the initiatives are complete, and there are no new projects underway.

This year we opened a new in-store branch at the expanded Robin Hood store. Initial indications are that the branch will exceed growth projections. We also launched several new credit card products. Both of these projects were costly to initiate but are expected to create continuing value as they allow us to tap into higher yielding consumer loan business.

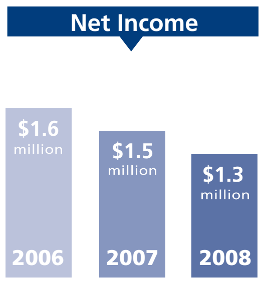
In line with other financial institutions, we are seeing an increase in arrears as Bahamian borrowers struggle to meet their financial obligations. Central Bank of The Bahamas statistics show loan arrears (defined as loans past due more than 31 days) to be near 14% with continuing deterioration forecast for the balance of the year. Fidelity Bank's arrears are running roughly at half the industry rate, thanks to a greater concentration of real estate loans which traditionally have a much lower arrears rate.

Report from the
# Chief Executive Officer *continued...*

The Bank remains committed to assist clients who find themselves impacted by job losses or lower incomes by refinancing loans and extending the term. At the same time, however, we are focused on ensuring that the rate of deterioration in asset quality does not accelerate.




Our plans have been impacted by the contraction in the Bahamian economy and we expect to post modest growth for 2009. Our focus remains on containing operating costs, managing loan delinquency and retaining customers. The sharp drop in credit demand is improving domestic liquidity; deposit rates are expected to soften during the year, which will widen interest margins and help mitigate the increasing loan provisioning cost.




The Bahamian economy continues to suffer from the drop in tourism and general belt tightening is taking place in all sectors of the economy. 2009 will certainly be a difficult year, with prospects for modest recovery likely in 2010. Growth will remain anemic as the economy continues to be dependent on the US, which is not expected to see robust growth levels for several years. Foreign Direct Investment continues, albeit at much lower levels, and Government spending will provide a boost to the Bahamian economy in the near term. Overall, we expect 2009 to be a challenging year but expect our profitability to improve as we have largely completed the investments we made in repositioning the Bank to be a more competitive and opportunistic enterprise.

Our priority is to maintain a strong balance sheet, emphasizing credit quality and delivering superior service with innovative products. We remain committed to managing risk in these uncertain times and building value for our shareholders.

We thank our loyal customers, enthusiastic employees and our shareholders for your continuing support.

Anwer J. Sunderji
Chief Executive Officer

# Fidelity's line of Innovative Products


## Fidelity **Built-In** Savings Plans

Switch to Fidelity products - they have built-in savings plans:

- **MoneyBack Mortgage**
- **Debt$AVER LOAN**
- **Asue Visa Card**

## Fidelity Debt**$AVER** LOAN

Fidelity Debt$AVER Loan is a structured personal loan used for debt consolidation. As you pay down your loan a portion of the savings will be put into a Debt$AVER account to assist you in achieving your specific financial goals.



## Fidelity Asue Visa Card

- **Risk Free Asue**
- **You save as you spend**
- **It gives you MoneyBack**

Instantly qualify for $1,000 draw on The Fidelity Asue Visa Card with salary deduction of just $100 a month.

## Fidelity **MoneyBack** Mortgage

Switch your Mortgage to the new Fidelity MoneyBack Mortgage and make a bundle and save a bundle! We give you a monthly rebate and invest it for you and we pay all legal fees when you switch.

# Management Discussion & Analysis

During 2008, total assets of the Bank increased by $48.9 million, or 21.8% to $272.5 million from $223.6 million in 2007 with total loans increasing by $46.1 million, or 30.2%, compared to an increase of $40.1 million, or 35.6%, in 2007.

The Bank reported net income of $1,312,606 or 4.6 cents per share as compared with net income for 2007 of $1,466,780 or 5.1 cents per share. Net income for 2008 was in line with budgets and continues to be impacted by increased expenses from the Bank strategy of growing and investing for the longer term in people, premises and products. The Bank completed the rollout of its product range and upgrading of premises in 2008.

The return on assets for the year was 0.5% compared with 0.8%for 2007.

Dividends of 4 cents per share were paid in 2008 same as in 2007.

## CAPITAL ADEQUACY

The Bank's tier 1 capital is comprised of ordinary share capital and retained earnings while the Bank's tier 2 capital is comprised of tier 1 capital plus revaluation surplus. Using the risk weightings in accordance with the Basle Accord guidelines on capital adequacy, the Bank's ratios of risk weighted assets to tier 1 and tier 2 capital as at 31 December 2008 were 20.84% (2007: 25.87%) and 22.57% (2007 28.08% ).

The Central Bank guidelines require banks to have a minimum risk-weighted tier 2 capital of 8% with tier 1 capital of at least 4%.

## ANALYSIS OF LOAN PORTFOLIO

During 2008, the Bank increased its mortgage loans by $32.2 million (2007: $28.0 million), or 25.9% (2007: 29.4%).

Consumer and other loans increased by $14.6 million, (2007: $11.8 million) or 47.1% (2007: 62.4%). This increase in loans is due to the Bank focus on growing its business. Increased flexibility in loan pricing and related terms and conditions, together with innovative loan products were largely responsible for the strong growth in the loan book.

At the end of 2008, mortgage loans comprised 77.4% (2007: 80.0%) of total loans with consumer and other loans comprising the balance of 22.6% (2007: 20.0%) consistent with the Bank's loan targets.

Total non-performing loans amounted to $6.7 million (2007: $3.9 million) or 3.34% (2007: 2.53%) of total loans. Provision for loan losses represent 1.17% (2007: 1.38%) of the total loan portfolio.

# DEPOSIT BASE

The strong growth in demand for credit, combined with the increased financing requirements of The Bahamas Government resulted in reduction in liquidity in the Bahamian banking system and increased competition for deposits throughout 2007 and 2008. Liquidity has improved significant in the early months of 2009 and demand for credit has declined.

During 2008, total deposits grew by $47.7 million (2007: $48.5 million), or 29.4 %, (2007: 42.7%).

# OPERATING REVENUES

## Net Interest Income

Net interest income increased slightly from $7.4 million in 2007 to $8.8million in 2008. The net interest margin, on average total assets decreased from 3.8% in 2007 to 3.5% in 2008. Demand for funds remained strong throughout 2008 and costs remained high.

## Non-Interest Income

In line with the Bank's strategic plans, non-interest revenues, increased to $5.1 million in 2008 compared with $4.6 million in 2007. At the end of 2008, non-interest revenues comprised 36.9% (2007: 38.4%) of total revenues.

# OPERATING EXPENSES

Operating expenses have increased significantly from 2007. Excluding loan loss provision charges, expenses were $12.4 million (2007: $10.1 million) an increase of $2.3 million (2007: $2.3 million) or 22.4% (2007: 30.2%). The increase in expenses is the result of a Board decision to continue to grow the Bank at a fast rate as in previous year.

Part of this strategy required significant investment in:

- New premises and upgrading of existing premises
- Strengthening of the management team
- Training and education for staff
- Upgrading of software
- New product development and rollout
- Expansion of Western Union outlets
- Expansion of branch outlets

The Bank completed its upgrading strategy in 2008 and expects costs to stabilise enabling the Bank to reap the reward of its investment strategy.

## LOAN LOSS PROVISIONS

Non-performing loans as a percentage of total loans were 3.34% at the end of 2008 (2007: 2.53%). The level of loan loss provisions, as a percentage of non-performing loans, decreased from 54% in 2007 to 35% at the end of 2008. Provisions at 35% are consistent with the Bank's historical experience as losses on our mortgage portfolio have been minimal.

The Bank continues to make significant progress in managing its non-performing loans. 2009 is expected to be a challenging year due to the impact of the global recession on the Bahamian economy.

## NEW PRODUCTS & TECHNOLOGY

The Bank introduced credit cards during the year and continues to build this business. A new branch was opened in the ROBINHOOD store. This branch has exceeded budget for the year and is current at breakeven point.

## SUMMARY

The Bank had a successful year in implementing its strategy. New products were rolled out, premises were upgraded and new branches opened. Loan and deposit base were expanded.

While the Bank profitability in 2008 was adversely impacted by increased expenses arising from our strategy of investing in people, premises, systems and products, the Board remains optimistic that, the changes in the Bank's products and services, the refurbishment of the Bank's branches and the continued improvements to its management and staff will serve to further grow the Bank and improve its long term profitability.

2009 is expected to be a challenging year but the Bank is in a good position to weather this recession and continues to focus on building for the long term.

PRICEWATERHOUSECOOPERS

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**INDEPENDENT AUDITORS' REPORT**

**To the Shareholders of Fidelity Bank (Bahamas) Limited**

We have audited the accompanying consolidated financial statements of Fidelity Bank (Bahamas) Limited (the Bank) and its subsidiary (together, the Group), which comprise the consolidated balance sheet as of 31 December 2008, and the consolidated income statement, consolidated statement of changes in equity and consolidated cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

*Management's Responsibility for the Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with International Financial Reporting Standards. This responsibility includes: designing, implementing and maintaining internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error; selecting and applying appropriate accounting policies; and making accounting estimates that are reasonable in the circumstances.

*Auditors' Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with International Standards on Auditing. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements 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 entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

*Opinion*

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the financial position of the Group as of 31 December 2008, and its financial performance and its cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers

**Chartered Accountants**
**30 April 2009**

# FIDELITY BANK (BAHAMAS) LIMITED
(Incorporated under the laws of the Commonwealth of The Bahamas)

## Consolidated Balance Sheet as of 31 December 2008
(Amounts expressed in Bahamian dollars)

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| **ASSETS** | | |
| Cash on hand and at banks (Note 3) | 18,646,538 | 19,553,274 |
| Investment securities (Note 4) | 36,615,975 | 38,624,455 |
| Mortgages, consumer and other loans (Note 5) | 198,861,978 | 152,715,851 |
| Property, plant and equipment (Note 6) | 12,286,606 | 11,309,408 |
| Prepayments and other assets | 6,079,617 | 1,445,935 |
| **Total assets** | **272,490,714** | **223,648,923** |
| **LIABILITIES** | | |
| Customer deposits (Note 7) | 209,931,152 | 162,240,639 |
| Loan from bank | - | 146,403 |
| Debt securities (Note 8) | 28,107,262 | 27,172,674 |
| Accrued expenses and other liabilities (Note 9) | 1,483,632 | 1,286,478 |
| **Total liabilities** | **239,522,046** | **190,846,194** |
| **EQUITY** | | |
| Share capital (Note 10) | 20,000,001 | 20,000,001 |
| Revaluation surplus | 2,526,329 | 2,572,037 |
| Retained earnings | 10,442,338 | 10,230,691 |
| **Total equity** | **32,968,668** | **32,802,729** |
| **Total liabilities and equity** | **272,490,714** | **223,648,923** |

**APPROVED BY THE BOARD OF DIRECTORS AND SIGNED ON ITS BEHALF BY:**

William C. Allen

**Director**

A Sundry

**Director**

28 April 2009
**Date**

The accompanying notes are an integral part of these consolidated financial statements.

# FIDELITY BANK (BAHAMAS) LIMITED

## Consolidated Income Statement for the Year Ended 31 December 2008

(Amounts expressed in Bahamian dollars)

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| **INCOME** | | |
| Interest income | | |
| Bank deposits and loans | 17,312,334 | 11,285,974 |
| Investment securities | 1,283,413 | 1,168,388 |
| | 18,595,747 | 12,454,362 |
| Interest expense | (9,812,443) | (5,096,888) |
| **Net interest income** | **8,783,304** | **7,357,474** |
| Non-interest income | 5,139,846 | 4,578,134 |
| | **13,923,150** | **11,935,608** |
| **EXPENSES** | | |
| Salaries and employee benefits | 5,771,289 | 4,786,115 |
| General and administrative | 5,541,219 | 4,447,262 |
| Provision for loan losses (Note 5) | 231,261 | 356,321 |
| Depreciation and amortisation (Note 6) | 1,066,775 | 879,130 |
| | **12,610,544** | **10,468,828** |
| **Net income** | **1,312,606** | **1,466,780** |

| | | |
|---|---|---|
| **Weighted average number of ordinary shares outstanding** | **28,666,670** | **28,666,670** |
| **Earnings per share** | **$0.05** | **$0.05** |

The accompanying notes are an integral part of these consolidated financial statements.

# FIDELITY BANK (BAHAMAS) LIMITED

## Consolidated Statement of Changes in Equity for the Year Ended 31 December 2008

(Amounts expressed in Bahamian dollars)

| | Share Capital $ | Revaluation Surplus $ | Retained Earnings $ | Total $ |
|---|---|---|---|---|
| As of 1 January 2007 | 20,000,001 | 2,621,619 | 9,860,996 | 32,482,616 |
| Depreciation transfer | - | (49,582) | 49,582 | - |
| Net income | - | - | 1,466,780 | 1,466,780 |
| Dividends | - | - | (1,146,667) | (1,146,667) |
| **As of 31 December 2007** | **20,000,001** | **2,572,037** | **10,230,691** | **32,802,729** |
| As of 1 January 2008 | 20,000,001 | 2,572,037 | 10,230,691 | 32,802,729 |
| Depreciation transfer | - | (45,708) | 45,708 | - |
| Net income | - | - | 1,312,606 | 1,312,606 |
| Dividends | - | - | (1,146,667) | (1,146,667) |
| **As of 31 December 2008** | **20,000,001** | **2,526,329** | **10,442,338** | **32,968,668** |

**Dividends per share: $0.04 (2007: $0.04)**

The accompanying notes are an integral part of these consolidated financial statements.

# FIDELITY BANK (BAHAMAS) LIMITED

## Consolidated Cash Flow Statement for the Year Ended 31 December 2008

(Amounts expressed in Bahamian dollars)

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net income | 1,312,606 | 1,466,780 |
| Adjustments for: | | |
| Interest income | (18,595,747) | (12,454,362) |
| Interest expense | 9,812,443 | 5,096,888 |
| Provision for loan losses | 231,261 | 356,321 |
| Depreciation and amortisation | 1,066,775 | 879,130 |
| Net change in unrealised appreciation/depreciation in investment securities | 1,687,613 | (1,063,761) |
| Realised gains on investment securities | (6,859) | - |
| (Gain)/Loss on disposal of property, plant and equipment | (4,617) | 8,216 |
| Interest received | 17,906,253 | 11,978,247 |
| Interest paid | (8,839,967) | (4,317,506) |
| **(Increase)/Decrease in operating assets** | | |
| Mandatory reserve deposits | (1,758,048) | (2,061,460) |
| Mortgages, consumer and other loans | (45,699,837) | (39,998,919) |
| Prepayments and other assets | (4,633,682) | (852,926) |
| **Increase/(Decrease) in operating liabilities** | | |
| Customer deposits | 46,802,647 | 47,988,806 |
| Accrued expenses and other liabilities | 197,154 | (1,474,346) |
| **Net cash flows from/(used in) operating activities** | **(522,005)** | **5,551,108** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of investment securities | (162,690) | (17,923,101) |
| Proceeds from sale of investment securities | 502,359 | - |
| Purchase of property, plant and equipment | (2,108,356) | (2,899,316) |
| Proceeds from sale of property, plant and equipment | 69,000 | - |
| **Net cash flows used in investing activities** | **(1,699,687)** | **(20,822,417)** |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Repayment of loan from bank | (146,403) | (201,848) |
| Issuance of debt securities | 6,850,000 | 26,933,675 |
| Repayment of debt securities | (6,000,022) | - |
| Dividends paid | (1,146,667) | (1,146,667) |
| **Net cash flows from/(used in) financing activities** | **(443,092)** | **25,585,160** |
| **Net increase/(decrease) in cash and cash equivalents** | **(2,664,784)** | **10,313,851** |
| Cash and cash equivalents as of beginning of year | 13,997,252 | 3,683,401 |
| **Cash and cash equivalents as of end of year** | **11,332,468** | **13,997,252** |

The accompanying notes are an integral part of these consolidated financial statements.

# FIDELITY BANK (BAHAMAS) LIMITED

## Notes to the Consolidated Financial Statements
31 December 2008

### 1. General Information

Fidelity Bank (Bahamas) Limited (the Bank) is incorporated under the Companies Act, 1992 of the Commonwealth of The Bahamas (The Bahamas) and is licensed under the Banks and Trust Companies Regulation Act, 2000 to carry on banking business in The Bahamas. The Bank offers a full range of retail banking services, including internet and telephone banking, acceptance of deposits, granting of loans and the provision of foreign exchange services through each of its four branches in New Providence, its branch on Paradise Island, its branch in Grand Bahama and its branch in Abaco.

The Bank has one subsidiary, West Bay Development Company Limited, a property holding company incorporated in The Bahamas, which owns a building principally occupied by the Bank and its related parties. The Bank and its subsidiary are collectively referred to as the Group.

Fidelity Bank & Trust International Limited (the Parent), a company incorporated in The Bahamas, owns 75% (2007: 75%) of the issued ordinary shares of the Bank, with the balance being held by the Bahamian public.

The registered office of the Bank is situated at #51 Frederick Street, Nassau, Bahamas. As of 31 December 2008, the Bank employed 162 (2007: 153) persons.

The shares of the Bank are listed on The Bahamas International Stock Exchange (BISX).

### 2. Summary of Significant Accounting Policies

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below. These policies have been consistently applied to all years presented, unless otherwise stated.

#### (a) Basis of preparation

The consolidated financial statements are prepared in accordance with International Financial Reporting Standards (IFRS), and under the historical cost convention, except as disclosed in the accounting policies below.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise judgment in the process of applying the Group's accounting policies. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. Actual results could differ from those estimates. The areas involving a higher degree of judgment or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed in Notes 2(d), 2(g) and 11.

Interpretations to existing standards that became effective for fiscal periods beginning on or after 1 January 2008 were not relevant to the Group's operations and accordingly did not impact the Group's accounting policies or consolidated financial statements.

With the exception of the amendments to IAS 1 *Presentation of Financial Statements* that become effective for fiscal periods beginning on or after 1 January 2009, the application of new standards and amendments and interpretations to existing standards that have been published but are not yet effective are not expected to have a material impact on the Group's accounting policies or consolidated financial statements in the period of initial application. Upon adoption, the amendments to IAS 1 will require non-owner changes in equity to be presented separately from owner changes in equity, resulting in a statement of comprehensive income. Additionally, when the Group restates corresponding information, the amendments to IAS 1 will require the presentation of a restated balance sheet as of the beginning of the corresponding period.

**2. Summary of Significant Accounting Policies (Continued)**

**(b) Principles of consolidation**

Subsidiaries are all entities over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

Inter-company transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of impairment of the asset transferred. Accounting polices of subsidiaries are changed where necessary to ensure consistency with the policies adopted by the Group.

**(c) Foreign currency translation**

*i) Functional and presentation currency*

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (the functional currency). The consolidated financial statements are presented in Bahamian dollars (B$), which is the Bank's functional and presentation currency.

*ii) Transactions and balances*

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the date of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation of monetary assets and liabilities denominated in foreign currencies are recognised in the consolidated income statement. Translation differences on financial assets measured at fair value through profit or loss are included as part of the fair value gains and losses.

**(d) Financial assets**

The Group classifies its financial assets in the following categories: financial assets at fair value through profit or loss and loans and receivables. Management determines the classification of its financial assets at initial recognition.

*i) Financial assets at fair value through profit or loss*

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Investment securities have been designated as financial assets at fair value through profit or loss.

**2. Summary of Significant Accounting Policies (Continued)**

**(d) Financial assets (continued)**

*ii) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable.

Regular-way purchases and sales of financial assets are recognised on the trade date – the date on which the Group commits to originate, purchase or sell the asset. Financial assets are initially recognised at fair value plus transaction costs, except financial assets carried at fair value through profit or loss where such costs are expensed as incurred. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or when the Group has transferred substantially all risks and rewards of ownership.

Financial assets at fair value through profit or loss are subsequently carried at fair value. Fair value is based on quoted prices for investments quoted in an active market (e.g. international securities exchange) or valuation techniques, including recent arm's length transactions, discounted cash flow analysis and other valuation techniques commonly used by market participants, for securities not traded in active market. Loans and receivables are subsequently carried at amortised cost less provisions for impairment.

Gains or losses arising from sales or changes in fair value of financial assets at fair value through profit or loss are recognised in the consolidated income statement within "non-interest income" in the period in which they arise.

**(e) Non-performing assets**

All loans on which principal or interest payments are overdue in excess of ninety days are classified by management as non-performing, and monitored closely for impairment.

**(f) Borrowings**

Borrowings, which include loan from bank and debt securities, are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently recognised at amortised cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the consolidated income statement over the period of the borrowings using the effective interest method.

**(g) Income and expense recognition**

Interest income and expense are recognised in the consolidated income statement for all instruments measured at amortised cost using the effective interest method. Loan origination fees for loans that are likely to be drawn down are deferred (together with related direct costs) and recognised as an adjustment to the effective interest rate on the loans.

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability.

**2. Summary of Significant Accounting Policies (Continued)**

**(g) Income and expense recognition (continued)**

When calculating the effective interest rate, the Group estimates cash flows considering all contractual terms of the financial instrument (for example, prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

Fee and commission income is recognised on the completion of the underlying transaction, which is generally at the time the customer's account is charged. Dividend income is recognised in the consolidated income statement when the Group's right to receive payment has been established.

Other income and expenses are recognised on the accrual basis.

**(h) Offsetting financial instruments**

Financial assets and liabilities are offset and the net amount reported in the consolidated balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

**(i) Impairment of financial assets at amortised cost**

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a loss event) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the consolidated income statement. If a loan has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract. As a practical expedient, the Group may measure impairment on the basis of an instrument's fair value using an observable market price.

**(j) Property, plant and equipment**

Property, plant and equipment, other than land and buildings, are carried at historical cost less accumulated depreciation and amortisation. Historical cost includes expenditure that is directly attributable to the acquisition of an item. Land and buildings, which comprise branches and offices for the Group's operations, are carried at fair value based upon periodic independent appraisals that are commissioned at intervals not exceeding three years, less subsequent depreciation for buildings.

Subsequent costs are included in the asset's carrying amount or are recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably. All repairs and maintenance are charged to the consolidated income statement during the financial period in which they are incurred.

2. **Summary of Significant Accounting Policies (Continued)**

**(j) Property, plant and equipment (continued)**

Increases in the carrying amount arising on revaluation of land and buildings are credited to "revaluation surplus" in equity. Decreases that offset previous increases of the same asset are charged against revaluation surplus directly in equity; all other decreases are charged to the consolidated income statement. Each year the difference between depreciation based on the revalued carrying amount of the asset charged to the consolidated income statement and depreciation based on the asset's original cost is transferred from revaluation surplus to retained earnings.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate costs (net of residual values) over estimated useful lives as follows:

| | Estimated Useful Life |
|---|---|
| Buildings | 30 - 50 years |
| Furniture and fixtures | 3 - 10 years |
| Motor vehicles | 3 - 5 years |
| Computer software and office equipment | 3 - 10 years |
| Leasehold improvements | Lesser of lease term and 3 - 10 years |

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date.

Assets that are subject to depreciation and amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount. The recoverable amount is the higher of the asset's fair value less costs to sell and value in use.

Gains and losses on disposals are determined by comparing proceeds with the carrying amount and are recognised in the consolidated income statement. When revalued assets are sold, amounts included in revaluation surplus are transferred directly to retained earnings.

**(k) Leases**

*i) The Group is the lessee*

The leases entered into by the Group are primarily operating leases. The total payments made under operating leases are charged to the consolidated income statement on a straight-line basis over the period of the lease.

When an operating lease is terminated before the lease period has expired, any payment required to be made to the lessor by way of penalty is recognised as an expense in the period in which termination takes place.

*ii) The Group is the lessor*

Leases comprise operating leases. Lease income is recognised over the term of the lease on a straight-line basis.

**2. Summary of Significant Accounting Policies (Continued)**

**(l) Share capital**

*i) Share issue costs*

Incremental costs directly attributable to the issue of new shares or options or to the acquisition of a business are shown in equity as a deduction from the proceeds.

*ii) Dividends*

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's Directors. Dividends for the year that are declared after the balance sheet date are disclosed in the subsequent events note.

**(m) Cash and cash equivalents**

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and unrestricted deposits with banks that have original contractual maturities of three months or less.

**(n) Provisions**

Provisions for restructuring costs and legal claims are recognised when the Group has a present legal or constructive obligation as a result of past events, and it is more likely than not that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated.

**(o) Employee benefits**

The Group's employees participate in a defined contribution pension plan of a related party, administered by trustees that include executives of the Bank.

A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the plan does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods. The contributions are recognised as employee benefits expense in the consolidated income statement when they are due. The Group has no further payment obligations once the recognised contributions have been paid.

**(p) Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of segments operating in other economic environments.

The vast majority of the Group's activities are retail banking and all of its activities are based in The Bahamas. Therefore the Group has only one business segment and one geographical segment that require segment reporting. As such, no segment disclosures are made in these consolidated financial statements.

**2. Summary of Significant Accounting Policies (Continued)**

**(q) Fiduciary activities**

The Group acts as custodian, trustee and in other fiduciary capacities that result in the holding or placing of assets on behalf of individuals, investment funds and other entities. These assets are excluded from these consolidated financial statements, as they do not belong to the Group.

**(r) Corresponding figures**

Where necessary, corresponding figures are adjusted to conform with changes in presentation in the current year.

**3. Cash on Hand and at Banks**

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| Cash on hand | 3,119,966 | 2,939,960 |
| Deposits at banks | 8,212,502 | 11,057,292 |
| Mandatory reserve deposits | 7,314,070 | 5,556,022 |
| | **18,646,538** | **19,553,274** |

Mandatory reserve deposits are placed with the Central Bank of The Bahamas (the Central Bank) to meet requirements of the Bank's licence and are not available for use in the Group's day to day operations. Cash on hand, and mandatory reserve deposits and other deposits with the Central Bank are non-interest-bearing. Deposits at banks earn interest rates ranging from 0.000% to 5.500% (2007: 0.000% to 4.000%).

For the purposes of the consolidated cash flow statement, cash and cash equivalents comprise cash on hand and deposits at banks.

**4. Investment Securities**

*Financial assets at fair value through profit or loss*

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| Government securities (Note 14) | 21,378,700 | 21,218,200 |
| Mutual fund shares (Note 8) | 14,845,751 | 17,026,674 |
| | 36,224,451 | 38,244,874 |
| Accrued interest | 391,524 | 379,581 |
| **Total** | **36,615,975** | **38,624,455** |

Government securities principally comprise Bahamas Government Registered Stock with maturities ranging from 2010 to 2033 (2007: 2010 to 2027) and with interest rates ranging from 0.094% to 1.250% above the B$ Prime rate of 5.500% (2007: 5.500%). As of 31 December 2008, the cost of investment securities totalled $36,685,153 (2007: $37,017,963).

# FIDELITY BANK (BAHAMAS) LIMITED

## Notes to the Consolidated Financial Statements (continued)
31 December 2008

### 5. Mortgages, Consumer and Other Loans

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| Mortgages | 156,209,727 | 124,074,700 |
| Consumer and other loans | 45,468,927 | 30,915,338 |
| | 201,678,654 | 154,990,038 |
| Loan origination fees | (1,370,158) | (843,732) |
| Accrued interest | 909,180 | 701,412 |
| Provision for loan losses | (2,355,698) | (2,131,867) |
| **Total** | **198,861,978** | **152,715,851** |

Movements in provision for loan losses are as follows:

| | 2008 | | | 2007 | | |
|---|---|---|---|---|---|---|
| | Mortgage | Consume<br>$ | Total<br>$ | Mortgages<br>$ | Consume<br>$ | Total<br>$ |
| Balance as of 1 January | 1,294,720 | 837,147 | 2,131,867 | 1,054,123 | 1,174,079 | 2,228,202 |
| Provision during the year | (208,60 ) | 439,865 | 231,261 | 240,597 | 115,724 | 356,321 |
| Write-offs during year | | (7,430) | (7,430) | - | (452,656) | (452,656) |
| **Balance as of 31 December** | **1,086,11** | **1,269,582** | **2,355,698** | **1,294,720** | **837,147** | **2,131,867** |

The provision for loan losses represents 1.17% (2007: 1.38%) of the total loan portfolio and 34.98% (2007: 54.43%) of total non-performing loans.

As of 31 December 2008, principal balances of non-performing loans totalled $6,734,209 (2007: $3,916,712), representing 3.34% (2007: 2.53%) of the loan portfolio.

## 6. Property, Plant and Equipment

| | Land & Buildings $ | Furniture & Fixtures $ | Motor Vehicles $ | Computer Software & Office Equipment $ | Leasehold Improvements $ | Total $ |
|---|---|---|---|---|---|---|
| **Cost or valuation:** | | | | | | |
| As of 1 January 2008 | 6,778,656 | 2,824,940 | 77,535 | 5,562,440 | 4,689,267 | 19,932,838 |
| Additions | - | 525,535 | 20,045 | 582,617 | 980,159 | 2,108,356 |
| Disposal | (78,656) | - | (27,650) | - | - | (106,306) |
| **As of 31 December 2008** | **6,700,000** | **3,350,475** | **69,930** | **6,145,057** | **5,669,426** | **21,934,888** |
| **Accumulated depreciation/ amortisation:** | | | | | | |
| As of 1 January 2008 | 196,901 | 1,717,128 | 40,224 | 4,276,254 | 2,392,923 | 8,623,430 |
| Charge for the year | 59,873 | 265,518 | 13,188 | 401,897 | 326,299 | 1,066,775 |
| Disposal | (14,273) | - | (27,650) | - | - | (41,923) |
| **As of 31 December 2008** | **242,501** | **1,982,646** | **25,762** | **4,678,151** | **2,719,222** | **9,648,282** |
| **Net book value:** | | | | | | |
| **As of 31 December 2008** | **6,457,499** | **1,367,829** | **44,168** | **1,466,906** | **2,950,204** | **12,286,606** |
| **As of 31 December 2007** | **6,581,755** | **1,107,812** | **37,311** | **1,286,186** | **2,296,344** | **11,309,408** |

Land and buildings were revalued by an independent appraiser as of 31 December 2006.

If land and buildings were stated on an historical cost basis, the amounts would be as follows:

| | 2008 $ | 2007 $ |
|---|---|---|
| Cost | 4,443,450 | 4,563,930 |
| Accumulated depreciation | (512,280) | (470,826) |
| **Net book value** | **3,931,170** | **4,093,104** |

## 7. Customer Deposits

| | 2008 $ | 2007 $ |
|---|---|---|
| Demand deposits | 20,455,653 | 18,441,291 |
| Savings certificates | 39,158,965 | 32,912,961 |
| Term deposits | 147,910,086 | 109,367,805 |
| | 207,524,704 | 160,722,057 |
| Accrued interest | 2,406,448 | 1,518,582 |
| **Total** | **209,931,152** | **162,240,639** |

All customer deposits carry fixed interest rates ranging from 2.500% to 7.250% (2007: 2.500% to 7.000%).

## 8. Debt Securities

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| Series A redeemable fixed rate (7.000%) notes; 2017 | 4,909,653 | 4,903,204 |
| Series B redeemable floating rate (B$ Prime + 1.750%) notes; 2022 | 9,812,359 | 9,806,407 |
| Series C redeemable fixed rate (7.000%) notes; 2013 | 2,958,803 | - |
| Series D redeemable floating rate (B$ Prime + 1.750%) notes; 2015 | 6,900,833 | - |
| Short-term note issued to related party | 3,227,855 | 12,227,877 |
| | 27,809,503 | 26,937,488 |
| Accrued interest | 297,759 | 235,186 |
| | **28,107,262** | **27,172,674** |

During the year, as part of a $50,000,000 note programme approved by the Directors during 2007, the Bank offered through private placement, $10,000,000 of unsecured fixed and floating rate notes consisting of Series C - $3,000,000 redeemable 7% fixed rate notes due 30 May 2013 and Series D - $7,000,000 redeemable floating rate notes (B$ Prime rate plus 1.750%) due 30 May 2015. Interest is payable semi-annually on 30 May and 30 November each year.

Costs of the notes issue totalled $150,000, all of which were paid to a related party, and are being amortised on an effective yield basis over the life of the notes.

In 2007, the Bank offered, through private placement, $15,000,000 of unsecured fixed and floating rate notes consisting of Series A - $5,000,000 redeemable 7% fixed rate notes due 19 October 2017 and Series B - $10,000,000 redeemable floating rate notes (B$ Prime rate plus 1.750%) due 19 October 2022. Interest is payable semi-annually on 19 April and 19 October each year.

Costs of the notes issue totalled $294,202 and are being amortised on an effective yield basis over the life of the notes. Of the total costs, $225,000 was paid to a related party.

On 30 November 2007, the Bank purchased mutual fund shares from a related party, Royal Fidelity Merchant Bank & Trust Limited (RFMBT) at the then current market value of $12,227,877. The transaction was settled by the issue of a promissory note equal to the purchase price, which is unsecured, accrues interest at the rate of 5.500% per annum and was payable on or before 31 May 2008. In May 2008, the agreement was amended and RFMBT agreed to subscribe for $3 million of Series D floating rate notes issued by the Bank in partial repayment and the balance to be repaid in monthly installments of $1,000,000 plus accrued interest commencing 4 July 2008 with interest at B$ Prime rate on the outstanding balance.

## 9. Accrued Expenses and Other Liabilities

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| Accrued expenses | 524,733 | 486,014 |
| Insurance premiums held in escrow | 768,726 | 679,462 |
| Due to related parties | 190,173 | - |
| Other | - | 121,002 |
| **Total** | **1,483,632** | **1,286,478** |

## 10. Share Capital

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| *Authorised* | | |
| 35,000,000 ordinary shares of $0.30 each | **10,500,000** | **10,500,000** |
| 10,000,000 preference shares of $1.00 each | **10,000,000** | **10,000,000** |
| *Issued & fully paid* | | |
| 28,666,670 ordinary shares | 8,600,001 | 8,600,001 |
| Share premium | 11,400,000 | 11,400,000 |
| **Total** | **20,000,001** | **20,000,001** |

## 11. Critical Accounting Estimates and Judgments in Applying Accounting Policies

The Group makes estimates and assumptions that affect the reported amounts of assets and liabilities within the next financial year. Estimates and judgments are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

### Impairment losses on mortgages, consumer and other loans

The Group reviews its loan portfolios to assess impairment at least on a quarterly basis. In determining whether an impairment loss should be recorded in the consolidated income statement, the Group makes judgments as to whether there is any observable data indicating that there is a measurable decrease in the estimated future cash flows from a portfolio of loans before the decrease can be identified with an individual loan in that portfolio.

This evidence may include observable data indicating that there has been an adverse change in the payment status of borrowers in a group, or national or local economic conditions that correlate with defaults on assets in a group. Management uses estimates based on historical loss experience for assets with credit risk characteristics and objective evidence of impairment similar to those in the portfolio when scheduling its future cash flows. The methodology and assumptions used for estimating both the amount and timing of future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

## 12. Employee Benefits

The Group participates in a defined contribution pension plan, Fidelity Merchant Bank & Trust Limited Employees Pension Plan (the Plan), which covers all employees of the Parent's Bahamas based operations. Under the Plan, all employees contribute 5% of gross salary and the Group matches employees' contributions.

Pension expense for the year ended 31 December 2008 totalled $262,916 (2007: $206,272), and is included in salaries and employee benefits in the consolidated income statement.

## 13. Related Party Balances and Transactions

Related parties include those entities and individuals that have the ability to control or exercise significant influence over the Group in making financial or operational decisions, and entities that are controlled, jointly controlled or significantly influenced by them.

Related party balances and transactions, not disclosed elsewhere in these consolidated financial statements, are as follows:

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| **ASSETS** | | |
| Cash at banks | 2,532,340 | 883,398 |
| Investment securities | 14,845,751 | 17,026,674 |
| Other assets | 4,986,357 | - |
| **LIABILITIES** | | |
| Customer deposits (excluding directors and officers) | 7,396,363 | 6,263,457 |
| Debt securities | 3,227,855 | 12,283,897 |
| **EXPENSES** | | |
| Group allocated costs and other related party expenses | - | 43,895 |
| Costs allocated to group companies | (1,363,827) | (1,109,951) |

The Bank provides certain services to the Parent and other related parties under service agreements.

Loans to and deposits from directors and officers totalled $2,207,860 (2007: $2,519,256), and $740,978 (2007: $518,930), respectively.

Key management compensation (excluding directors) for the year totalled $677,273 (2007: $726,600). Included in expenses to related parties above are costs for key management personnel compensation of related parties that have been allocated to the Group based on services provided to the Group by such personnel.

Directors' compensation for the year totalled $78,020 (2007: $61,000).

**14. Commitments**

*Loan commitments*

In the normal course of business, various credit-related arrangements are entered into to meet the needs of customers and earn income. These financial instruments are subject to the Group's standard credit policies and procedures. As of the consolidated balance sheet date, these credit-related arrangements were as follows:

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| Loan commitments | 15,700,827 | 20,043,866 |

*Lines of credit*

The Bank has pledged $3 million (2007: $3 million) of Bahamas Government Registered Stock to support a credit facility of the same amount with another Bahamian commercial bank. The facility bears interest at 0.500% above the B$ Prime rate up to $1 million and 1.250% above the B$ Prime rate for amounts in excess of $1 million with a stand by fee of 0.250% per annum on any unused portion of the facility.

As of 31 December 2008, the line of credit with the commercial bank was completely utilised and included in customer deposits (2007: line of credit was unutilised).

*Operating lease commitments*

The future minimum rental payments required under non-cancellable operating leases as of 31 December are as follows:

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| 2008 | - | 521,071 |
| 2009 | 511,370 | 446,570 |
| 2010 | 436,481 | 400,481 |
| 2011 | 397,333 | 360,353 |
| 2012 | 289,000 | 250,000 |
| 2013 | 289,000 | 250,000 |
| 2014 | 38,000 | - |
| 2015 | 38,000 | - |
| 2016 | 39,000 | - |
| 2017 | 39,000 | - |
| **Total minimum payments** | **2,077,184** | **2,228,475** |

**15. Contingent Liabilities**

The Group is involved in various legal proceedings covering a range of matters that arise in the ordinary course of business activities. Management is of the view that no significant losses will arise as a result of these proceedings.

## 16. Capital Management

The Group's objectives when managing capital, which is a broader concept than 'equity' on the face of the consolidated balance sheet, are:

- To comply with the capital requirements set by the Central Bank;
- To safeguard the Group's ability to continue as a going concern so that it can continue to provide returns for its shareholders and benefits for other stakeholders; and
- To maintain a strong capital base to support the development of its business.

Capital adequacy and the use of regulatory capital are monitored by the Group's management, employing techniques designed to ensure compliance with guidelines established by the Central Bank. The required information is filed with the Central Bank on a quarterly basis.

The Central Bank requires that the Bank maintains a ratio of total regulatory capital to risk-weighted assets at or above a minimum of 8%.

The table below summaries the composition of regulatory capital and shows the capital adequacy ratio of the Group, determined in accordance with the Basle Accord, as of the consolidated balance sheet date. During 2008, the Group complied with all of the externally imposed capital requirements to which it is subject.

| | 2008<br>$ | 2007<br>$ |
|---|---|---|
| **Tier 1 capital** | | |
| Share capital | 20,000,001 | 20,000,001 |
| Retained earnings | 10,442,338 | 10,230,691 |
| | 30,442,339 | 30,230,692 |
| **Tier 2 capital** | | |
| Revaluation surplus | 2,526,329 | 2,572,037 |
| **Total** | **32,968,668** | **32,802,729** |
| **Risk-weighted assets** | **146,060,668** | **116,834,824** |
| **Capital adequacy ratio – Tier 1** | **20.84%** | **25.87%** |
| **Capital adequacy ratio – Tier 1 and 2** | **22.57%** | **28.08%** |

## 17. Financial Risk Management

*Strategy in using financial instruments*

By their nature, the Group's activities are principally related to the use of financial instruments. The Group accepts deposits from customers at both fixed and floating rates, and for various periods, and seeks to earn above-average interest margins by investing these funds in high-quality assets – predominantly mortgages. The Group seeks to increase these margins by consolidating short-term funds and lending for longer periods at higher rates, while maintaining sufficient liquidity to meet all claims that might fall due.

## 17. Financial Risk Management (Continued)

*Strategy in using financial instruments (continued)*

The Group also seeks to raise its interest margins by obtaining above-average margins, net of allowances, through lending to commercial and retail borrowers with a range of credit standings. Such exposures involve not just on-balance sheet loans and advances but include guarantees and other commitments such as letters of credit, and performance and other bonds.

The principal risks which arise from the Group's core activities that must be effectively managed include credit, interest rate, price, liquidity and fiduciary risks. The Group does not use derivative instruments to manage any of these risks.

*Credit risk*

Credit risk is the risk that a counterparty may be unable to pay amounts in full when due. Impairment provisions are provided for losses incurred as of the consolidated balance sheet date (Note 5). Significant changes in the economy or a sector that represents a concentration in the Group's portfolio could result in losses that are different from those provided for as of the consolidated balance sheet date. Management therefore carefully manages its exposure to credit risk.

The credit committee is responsible for approving and monitoring the Group's credit exposure, which is done through review and approval of the lending policy, and limits on credit exposure to individual borrowers and sectors.

Prior to advancing funds, an assessment is made of the credit quality of each borrower. The Group does not use an automated credit scoring system. It is the Group's policy to lend responsibly and establish loans that are within a customer's ability to repay rather than relying exclusively on security.

Maximum credit exposure at the year end approximates the carrying value of all assets. The classes of financial instruments to which the Group is most exposed are loans to customers (Note 5) and certain investment securities (Note 4).

The table below provides further information on mortgages, consumer and other loans by payment due status as of 31 December.

| | 2008 | | 2007 | |
|---|---|---|---|---|
| | $m | % | $m | % |
| **Not impaired** | | | | |
| - Neither past due or impaired | 190.8 | 94.6 | 150.2 | 96.9 |
| - Past due up to 3 months but not impaired | 4.2 | 2.1 | 0.9 | 0.6 |
| **Impaired** | | | | |
| - Past due 3 – 6 months | 4.2 | 2.1 | 1.1 | 0.7 |
| - Past due 6 – 12 months | 1.4 | 0.7 | 1.1 | 0.7 |
| - Past due over 12 months | 1.1 | 0.5 | 1.7 | 1.1 |
| | **201.7** | **100.0** | **155.0** | **100** |

### 17. Financial Risk Management (Continued)

*Credit risk (continued)*

Of the $156 million (2007: $124 million) of mortgage loans, $126 million (2007: $99 million) are supported by family residential property, $26 million (2007: $21 million) by undeveloped land and $4 million (2007: $4 million) by commercial property. Of the $45 million (2007: $31 million) consumer loans, $7 million (2007: $6 million) are cash secured, $11 million (2007: $6 million) are funded by salary deductions from employers and $6 million (2007: $6 million) are overdraft facilities to customers.

The average mortgage loan balance is $89,000 (2007: $85,000) and the average consumer loan balance is $20,000 (2007: $18,000) with the largest exposure to a single customer totalling approximately $1.4 million (2007: $1.4 million). Mortgage loans can extend up to 24 years, and consumer loans up to 10 years.

Non-performing loans of $6.7 million (2007: $3.9 million) are comprised of mortgage loans totalling $5.4 million (2007: $3.1 million) and consumer loans totalling $1.3 million (2007: $0.8 million).

Credit-related commitments

The primary purpose of these instruments is to ensure that funds are available to a customer as required. Guarantees – which represent irrevocable assurances that the Group will make payments in the event that a customer cannot meet its obligations to third parties – carry the same credit risk as loans.

Commitments to extend credit represent unused portions of authorisations to extend credit in the form of loans, guarantees or letters of credit. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. However, the likely amount of loss is less than the total unused commitments, as most commitments to extend credit are contingent upon customers maintaining specific credit standards. The Group monitors the term to maturity of credit commitments because longer-term commitments generally have a greater degree of credit risk than shorter-term commitments.

Geographical concentrations of financial assets

The Group has a concentration of risk in respect of geographical area, as both customers and assets held as collateral are primarily based in The Bahamas.

*Interest rate risk*

Interest rate risk is the risk that the future cash flows or fair value of a financial instrument will fluctuate because of changes in market interest rates. The Group takes on exposure to the effects of fluctuations in the prevailing levels of market interest rates on both its fair value and cash flow risks. Interest margins may increase as a result of such changes but may reduce gains or create losses in the event that unexpected movements arise.

The Group does not attempt to hedge specifically against the impact of changes in market interest rates on cash flow and interest margins and relies on the fact that the loan portfolio is based on floating interest rates linked to the B$ Prime rate that generally reset within three months of any rate change and has financial liabilities that offset these loans but at lower floating interest rates. The Bank maintains a general policy of fixing the interest rate spread between interest earned on financial assets and interest incurred on financial liabilities.

## 17. Financial Risk Management (Continued)

*Interest rate risk (continued)*

The Group is exposed to fair value interest rate risk on $8 million (2007: $5 million) of its debt securities which are at fixed interest rates for 5 to 10 years, and does not hedge against this risk. The remaining debt securities are at floating interest rates linked to the B$ Prime rate.

The Government securities in the Group's investment portfolio are at floating rates linked to the B$ Prime rate.

*Price risk*

Price risk is the risk that the fair value and/or amounts realised on sale of financial instruments may fluctuate significantly as a result of changes in market price. This risk is concentrated in investments in mutual fund shares. The investments in mutual fund shares are represented by investments in three funds, managed by a related party. Two of the funds' assets are Bahamas based and are 60% equity and 40% fixed income in one fund and 100% fixed income in another; and the third fund is invested in a basket of international indices. The funds' investments are diversified with no single investment exceeding 10% of the total portfolio and the funds do not leverage. Effective 1 January 2008, the Group entered into a yield management agreement with the Parent to limit its exposure to changes in market prices. Under the agreement the Parent guarantees a yield of 6% plus 25% of any gain in excess of the 6% yield with 75% of any gain in excess of 6% remitted to the Parent. The agreement resulted in the Group being entitled to $2,697,688 from the Parent, as a result of the underperformance of the funds. The balance is included prepayments and other assets.

*Liquidity risk*

Liquidity risk is the risk that the Group is not able to meet its financial obligations as they fall due or can do so at an excessive cost.

The Group's liquidity policy is to maintain sufficient liquid resources to cover cash flow imbalances and fluctuations in funding, to retain full public confidence in the solvency of the Group and to enable it to meet all financial obligations. This is achieved by maintaining a prudent level of liquid assets, through management control of the rate of growth of the business and maintaining high levels of capital.

As additional support, the Group maintains committed credit facilities of $3 million. These facilities, included in customer deposits, were drawn upon during the year and remain fully drawn down at the year end.

The table below analyses assets and liabilities into relevant maturity groupings based on the remaining period to the contractual maturity dates as of the consolidated balance sheet date.

| | Repayable on demand $m | Up to 3 months $m | 3 - 12 months $m | 1 – 5 years $m | More than 5 years $m | Total $m |
|---|---|---|---|---|---|---|
| **As of 31 December 2008** | | | | | | |
| **ASSETS** | | | | | | |
| Cash on hand and at bank | 18.6 | - | - | - | - | 18.6 |
| Investment securities | 14.8 | - | 0.3 | 7.8 | 13.7 | 36.6 |
| Mortgage, consumer and other loans | 1.0 | 3.3 | 10.5 | 27.0 | 157.1 | 198.9 |
| Other assets | 6.0 | - | - | - | 12.4 | 18.4 |
| **Total assets** | **40.4** | **3.3** | **10.8** | **34.8** | **183.2** | **272.5** |

## 17. Financial Risk Management (Continued)

*Liquidity risk (continued)*

| | Repayable on demand $m | Up to 3 months $m | 3 - 12 months $m | 1 – 5 years $m | More than 5 years $m | Total $m |
|---|---|---|---|---|---|---|
| **As of 31 December 2008** | | | | | | |
| **LIABILITIES** | | | | | | |
| Customer deposits | 59.7 | 40.2 | 96.4 | 13.6 | - | 209.9 |
| Loan from bank | | | | | | |
| Debt securities | - | 3.5 | - | 3.0 | 21.6 | 28.1 |
| Other liabilities | - | - | 1.5 | - | - | 1.5 |
| **Total liabilities** | **59.7** | **43.7** | **97.9** | **16.6** | **21.6** | **239.5** |
| **Net liquidity gap** | **(19.3)** | **(40.4)** | **(87.1)** | **18.2** | **161.6** | **-** |
| **As of 31 December 2007** | | | | | | |
| **ASSETS** | | | | | | |
| Cash on hand and at bank | 19.6 | - | - | - | - | 19.6 |
| Investment securities | 17.4 | 0.4 | - | 7.5 | 13.3 | 38.6 |
| Mortgage, consumer and other loans | 0.7 | 4.6 | 5.0 | 21.4 | 121.0 | 152.7 |
| Other assets | 1.5 | - | - | - | 11.2 | 12.7 |
| **Total assets** | **39.2** | **5.0** | **5.0** | **28.9** | **145.5** | **223.6** |
| **LIABILITIES** | | | | | | |
| Customer deposits | 51.2 | 39.1 | 58.4 | 13.5 | - | 162.2 |
| Loan from bank | 0.1 | - | - | - | - | 0.1 |
| Debt securities | - | - | 12.2 | - | 15.0 | 27.2 |
| Other liabilities | - | - | 1.3 | - | - | 1.3 |
| **Total liabilities** | **51.3** | **39.1** | **71.9** | **13.5** | **15.0** | **190.8** |
| **Net liquidity gap** | **(12.1)** | **(34.1)** | **(66.9)** | **15.4** | **130.5** | **-** |

Regulatory authorities set limits for liquidity balances. The requirements for the Bank are 20% of demand deposits and 15% of savings and fixed deposits. As of 31 December 2008, the Bank was in compliance with these requirements.

*Fiduciary risk*

The Group is susceptible to fiduciary risk, which is the risk that the Group may fail in carrying out certain mandates in accordance with the wishes of its customers. To manage exposure, the Group generally takes a conservative approach in its undertakings.

## 18. Fair Values of Financial Instruments

Financial instruments utilised by the Group comprise the recorded financial assets and liabilities disclosed in these consolidated financial statements. The Group's financial instruments are principally short-term in nature, have interest rates that reset to market rates, or are fair valued; accordingly, their fair value approximates their carrying value. For long-term financial liabilities with fixed interest rates, there has been no change in market rates since the issuance of the financial liabilities and therefore, the carrying value approximates fair value.

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