BF&M LIMITED

ANNUAL REPORT 2012

MISSION STATEMENT

To strengthen and further develop our position as the leading insurer in the jurisdictions where we do business, through a professional, innovative and caring approach to meeting all of the insurance needs of the community we serve. Through the excellence of our service, we intend to satisfy the aspirations of our staff, the needs of our policyholders, and the requirements of our shareholders.

CONTENTS

BERMUDA GROUP EXECUTIVE

R. John Wight, C.A., CPCU
President & Chief Executive Officer

Susan M. Reed, B.A., FLMI
Chief Operating Officer

Glen P. Gibbons, B.A., A.C.I.I.
Senior Vice President
BF&M General Insurance
Company Limited

Miguel DaPonte, C.F.A., M.B.A.
Senior Vice President
BF&M Investment Services Limited

Paul Matthews, B.A., FLMI
Senior Vice President
BF&M Life Insurance
Company Limited

Patrick Neal, B.A., CPCU
Senior Vice President
Business Development

Heather A. Bisbee, C.A.
Head of Financial Reporting

Gina A. Bradshaw, FLMI
Vice President
BF&M Life Insurance
Company Limited

Lynda A. Davidson Leader, B.A., C.A.
Vice President, Corporate Services

Holly A. Flook, RN, BSN
Vice President, Underwriting & Claims
BF&M Life Insurance
Company Limited

Debby L. Graham, P.H.R.
Vice President
Human Resources

Andrew Hanwell
Vice President, Personal Insurance
BF&M General Insurance
Company Limited

Rob Jackson, CFP, CLU
Vice President, Sales & Customer Relations
BF&M Life Insurance
Company Limited

Dennis Marinac, F.C.I.A., F.S.A.
Vice President & Life Actuary
BF&M Life Insurance
Company Limited

Alyson L. Nicol, C.A., C.P.A.
Vice President, Pensions
BF&M Life Insurance
Company Limited

Mike Rogers
Vice President
Information Technology

Henry Sutton, CPCU, ARe
Vice President, Customer Relations
BF&M General Insurance
Company Limited

Angela R. Tucker, C.A.
Vice President & Group Controller

DIRECTORS

[1] **Gavin R. Arton,** Chairman, Retired Senior Vice President, XL Capital Ltd.

[4] **Peter N. Cooper,** Retired Managing Director, A.S. Cooper & Sons, Ltd.

[2] **Nancy L. Gosling**, B.Comm., LL.D., C.G.A. President & Chief Executive Officer, Gosling Brothers Limited

[1] **Gregory D. Haycock,** FCA, J.P., Retired Senior Partner, KPMG

[2] **L. Anthony Joaquin,** FCA, Retired Managing Partner, Ernst & Young

[1] **Stephen W. Kempe,** President, Admiral Management Services Limited

Catherine S. Lord, B.Sc., J.P., Retired

[1] **Garry A. Madeiros,** OBE, FCA, J.P., Retired President & CEO, Belco Holdings Limited (now named Ascendant Group Limited)

[2] **Aaron E. Smith,** B.Sc. (Hons), M.B.A., Chairman & CEO, Igility Group of Companies

[1] **Richard D. Spurling,** Retired Partner, Appleby, Barristers & Attorneys

[1] **Ann B. Teixeira,** LLIF, Consultant, Retired Life Insurance Executive, Sun Life Financial (U.S.)

[2] **C.L.F. “Lee” Watchorn,** F.C.I.A., F.S.A., President, Watchorn Advisory Group

[3] **David A. J. G. White,** President & Managing Director, Knick Knack Co. Ltd.

R. John Wight, C.A., CPCU, President & Chief Executive Officer, BF&M Limited

[1] Finance, Compensation & Corporate Governance Committee
[2] Audit, Compliance & Corporate Risk Management Committee
[3] Resigned April 2013
[4] Retired May 2013

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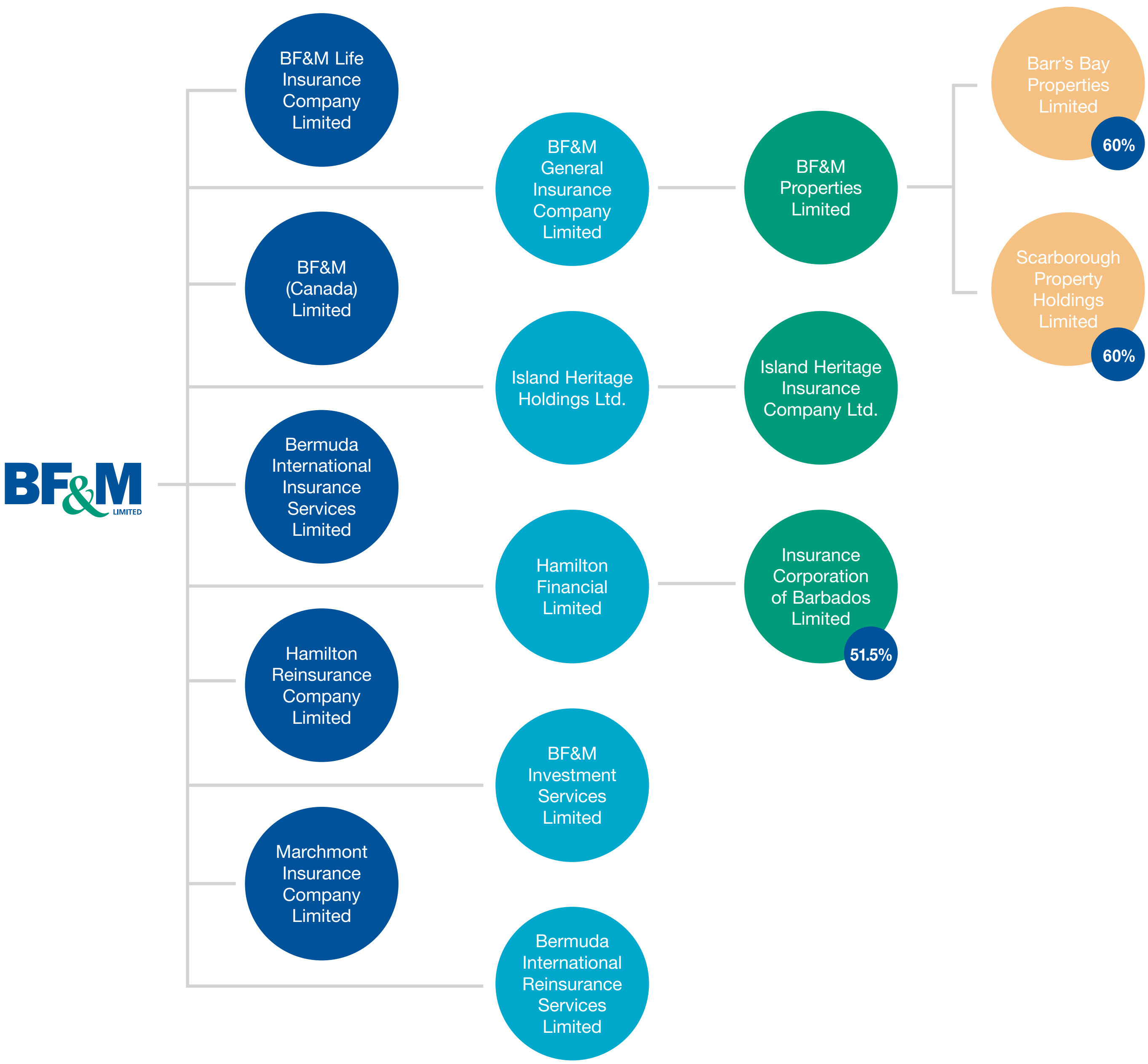
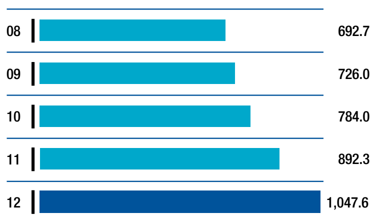
CORPORATE STRUCTURE

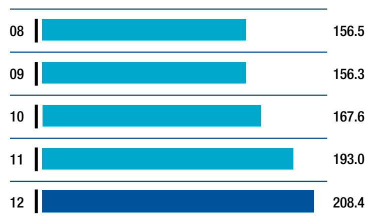


FINANCIAL & STATISTICAL SUMMARY

At End of Year



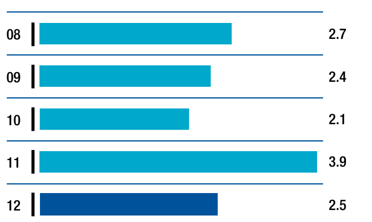
Total General Fund Assets
in millions of dollars



Shareholders' Equity
in millions of dollars

Number of Common Shares
in millions

Per Common Share

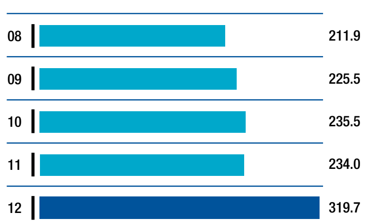


Net Earnings
in dollars

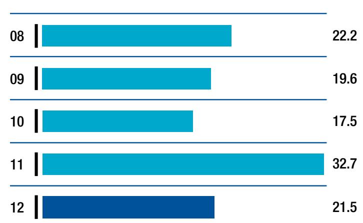
Cash Dividends
in cents

Book Value
in dollars

For the Year



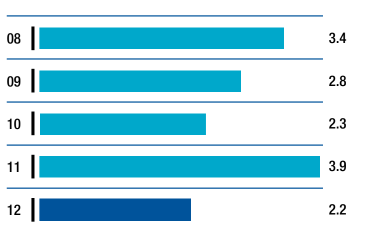
Gross Premiums Written
in millions of dollars



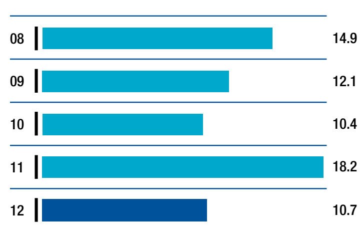
Shareholders' Net Income
in millions of dollars

Dividends Declared
in millions of dollars

Financial Ratios



Return on Assets
percentage



Return on Common Shareholders' Equity
percentage

2012 will be remembered as the year when BF&M Limited ("BF&M"), further extended its reach in the Caribbean region in a significant and positive way.

Based on continuing good financial performance during 2012, the Company maintained the same level of dividends in 2012 as 2011.

10.7%
2012 Return on Shareholders' Equity

R. John Wight, C.A., CPCU
President and Chief Executive Officer

Gavin R. Arton
Chairman

SHAREHOLDERS' REPORT

2012 will be remembered as the year when BF&M Limited ("BF&M"), through its acquisition of Island Heritage Holdings Ltd., further extended its reach in the Caribbean region in a significant and positive way. Net earnings for BF&M Limited for the year ended 31 December 2012 were $21.5 million. This compared with earnings of $32.7 million for 2011. In comparing the financial performance of 2012 against 2011 it is important to recall that 2011 had a one-time gain of $9.6 million related to the future funding of the Company's retiree health plan. This gain was fully recognized in the 2011 financial statement year, and thus did not re-occur in 2012.

Return on shareholders' equity for 2012 was 10.7%. Return on shareholders' equity for 2011, excluding the one-time gain referred to above, was 13%. Based on continuing good financial performance during 2012, the Company maintained the same level of dividends in 2012 as 2011.

We were pleased that rating agency A.M. Best maintained their Financial Strength Ratings for BF&M's four principal operating companies. A.M. Best's rating system is designed to provide an opinion of an insurer's financial strength and ability to meet ongoing obligations to policyholders. Their opinions are derived from an evaluation of a company's balance sheet strength, operating performance and business profile. A.M. Best's ratings for these companies are as follows:

- BF&M General Insurance Company Limited – "A" Excellent
- BF&M Life Insurance Company Limited – "A" Excellent
- Insurance Corporation of Barbados Limited – "A-" Excellent
- Island Heritage Insurance Company Ltd. – "A-" Excellent

The ratings are the strongest of any local insurer in the respective marketplaces for these companies.

In referring to BF&M's acquisition in 2012 of Cayman based Island Heritage, it is important to note the reasons why the BF&M Board of Directors determined this to be the right decision. The strategic benefits to BF&M are numerous. Island Heritage has had a very impressive earnings track record for many years, due to a business model well executed by a strong management team and staff. The addition of Island Heritage following BF&M's investment in the Insurance Corporation of Barbados in 2006, means that we have well balanced and diversified businesses in the islands in the Caribbean where we are confident of success. BF&M had been holding surplus assets yielding relatively low yields due to the global interest rate environment, and the deployment of this capital to purchase a strong Caribbean insurer with significantly higher returns simply made good business sense. In addition, the economies of scale through this acquisition make the BF&M Group stronger and potentially more profitable. We are very pleased to have Island Heritage join the BF&M Group.

As we note every year in our report, the accounting policy under International Financial Reporting Standards for valuing investments, in life enterprises in particular, can and often does lead to significant volatility of financial results. The Company records its investments at fair value, which in 2012 resulted in an increase to income of $5.9 million. This compared to an increase of $25.6 million in 2011.

In order to mitigate some of this volatility from year to year, the Company has adopted and follows a disciplined asset liability matching policy, so that increases (or decreases) in the fair value of the majority of its investments are matched with corresponding increases

BF&M LIMITED

Sponsoring the Bermuda Cancer & Health's Breast Cancer Awareness Walk is a way to ensure BF&M makes a meaningful contribution to the fight against a disease that impacts so many in our community.

Wellness matters at any age. That is why BF&M supports the Interschool Fitness Challenge, which is an island-wide youth program to get local middle and senior school students moving and fit.

BF&M was once again selected as one of Bermuda's Top Employers in 2012 by Bottom Line Magazine.

In reviewing the financial performance of BF&M Limited for 2012, we were pleased with the operational results.

(or decreases) in insurance reserves, reducing the net effect on earnings in any one year. In 2012, the difference between fair valuing investments and reserves for BF&M's life insurance companies produced a net gain of approximately $2 million. In 2011, the net difference resulted in a gain of approximately $5 million.

In reviewing the financial performance of BF&M Limited for 2012, we were pleased with the operational results for group insurance operations, however we were disappointed that the prolonged and severe economic climate and depressed real estate market in Bermuda resulted in certain mortgagees potentially unable to fulfill their contractual obligations to the Company. This resulted in the requirement to record an impairment provision of approximately $5 million in the consolidated statement of income. The challenging economic environments in the other islands where the BF&M Group operate mirrored those of Bermuda. Unfortunately 2013 looks very much like a continuation of the 2012 economic climate and it may take several years before we see significant improvement in these regions. In the meantime our businesses continue to perform well against their peers.

BF&M had eight profit centres in 2012 which we will report on as follows:

- Bermuda General Insurance
- Bermuda Health & Life Insurance, Pension Administration Services
- Barbados Operations
- Cayman Operations
- Bermuda Investment Services
- Bermuda Real Estate
- International Life Insurance Services
- International Life Reinsurance Services

BERMUDA GENERAL INSURANCE

Net earnings in 2012, when isolating out the one-time gain in 2011 referred to previously in this report, were consistent with 2011. The focus for 2012 was retention of existing business and these ratios were largely achieved. The Company experienced growth in the home account in 2012 in a difficult market. The 2012 motor vehicle premiums were below 2011 numbers, however, the total number of vehicles insured remained constant. This reflects the fact that in a challenging economic environment many residents are foregoing the purchase of new vehicles with higher values, in favour of retaining their existing vehicles which have a lower value.

2012 was another busy year for claims with claims incurred on par with 2011. Bermuda was spared the wrath of a hurricane in 2012 which helped to positively influence the loss experience. The motor loss ratio was in line with that of 2011.

The Company continued the practice of purchasing a conservative reinsurance program with world class reinsurers. Our ongoing practice of maintaining strategic relations with superior rated reinsurers does benefit the company.

The Company filed its second Commercial Insurer Solvency Self Assessment with the Bermuda Monetary Authority. Compliance and Enterprise Risk Management continues to be an increasing component of management's time in the regulatory environments that all group companies operate in.

BERMUDA HEALTH & LIFE INSURANCE, PENSION ADMINISTRATION SERVICES

While operating results improved in 2012 versus 2011, the mortgage impairments referred to earlier in this report resulted in decreased earnings year on year.

In March 2012, BF&M acquired Island Heritage Holdings Ltd., the parent company of Island Heritage Insurance Company Ltd. in Cayman.

Island Heritage's annual Charity Drive has proven to be a very successful fundraising initiative. By getting their community involved in the giving spirit, the company raised over $10,000 in 2012.

As an environmentally friendly company, Island Heritage promotes the "green" movement by being one of the lead sponsors of the 2012 Caribbean International Electric Auto Show.

Looking ahead, forward planning is evidenced by our significant investment in technology and organizational management.

As the health insurance industry globally struggles with rising health care costs, our focus turns to maximizing value whilst creating a unique and caring, customized approach to customer service. Despite market pressures, our clients remain the focus of collaborative efforts to combat the unsustainability of this sector.

In 2012, despite a reduction in total claims paid, the dollar amount spent per individual member increased. Higher than normal costs for cancer care and transplant related medical services were the main drivers of this experience.

It should, however, be noted that since 2009 our spending on domestic standard hospital benefits (as a percent of total claims spend) has increased. In recent years multiple services have been added to the standard hospital benefit package; despite increasing the community rated premium, loss ratios are worsening as evidenced by published actuarial reports.

Looking ahead, forward planning is evidenced by our significant investment in technology and organizational management. This positions us well for healthcare's future state which will command greater efficiencies, innovative options for cost reduction and self-directed choice.

Empowerment is also on the agenda. We continue to strive to positively impact long term health outcomes through a commitment to consumer health education, wellness and prevention, community activism, and partnership with all stakeholders.

BARBADOS OPERATIONS

The results of BF&M's 51.5% ownership interest in the Insurance Corporation of Barbados Limited ("ICBL") continue to benefit the group through geographical diversification. The net earnings for the company were up marginally over the prior year. Although the Barbados economy remained sluggish in 2012, the business grew in all major lines of business.

Auto claims in Barbados continue to be of concern, with the number of motor vehicle accidents and fatalities increasing at a disturbing rate. ICBL is embarking on a Road Safety Education Program in 2013 to assist in addressing this serious issue. Despite the increase in the number of losses, ICBL's auto insurance line continues to be profitable and is the largest provider of premium income to the company.

The good performance in 2012 was the result of new leadership with a strong focus on excellence in the fundamentals; prudent risk selection, adherence to sound underwriting discipline, broker relationships and management, claims management, customer service and commitment to our corporate strategy.

In 2012, the Company leveraged these strong fundamentals by integrating major technological enhancements into the life insurance operations. These enhancements, combined with the company's strong operational practices, brought a high-quality suite of products, powerful data warehousing and agile market segmentation capabilities. This demonstrated that ICBL is committed to being a leader in the life insurance market in Barbados, a line of business that was started following BF&M's investment in the company in 2006.

CAYMAN OPERATIONS

The results of BF&M's newly acquired ownership in Island Heritage were very good. As BF&M acquired the company on 30 March 2012, BF&M's earnings for 2012 include the results of Island Heritage from that date. Island Heritage is a relatively young company having been formed in 1996, however its growth since then has been very impressive. It writes property and casualty business in 14 islands

ICBL recently became a certified Green Business, and celebrated with their customers by giving away plants as an eco-friendly thank you.

ICBL believes in the future of young entrepreneurs and has entered into a three year partnership with the Junior Achievement Barbados where professionals volunteer their time in helping students understand, create and manage their own small enterprise projects. So far they have donated $30,000 to this cause.

BF&M continued on its path of strong Company results over the past year, and much of that is due to our hard working and dedicated management and staff.

in the Caribbean, predominately in Cayman, Bahamas, and the U.S. Virgin Islands. Reported earnings for Island Heritage in 2012 increased over 2011 despite the effect of Hurricane Sandy, which hit the Bahamas but fortunately had little effect in areas where that region's population bases were the largest.

BERMUDA INVESTMENT SERVICES

BF&M Investment Services Limited ("BFMISL") provides pension investment management and consulting services and is fully licensed with the Bermuda Monetary Authority under the Investment Business Act. The company provides a full range of separately managed accounts and mutual funds to meet client requirements. BFMISL has distribution agreements with over 30 internationally recognized mutual fund managers and through these managers our clients have access to over 90 individual funds. BFMISL was a beneficiary of the strong equity and bond market performance in 2012. Stock markets saw a double digit increase which helped to increase client account balances. BFMISL began working with Hewitt EnnisKnupp, an Aon company, in 2012, an independent investment consultant with over $4 trillion in assets under advisement and over 600 investment professionals worldwide. BFMISL will be combining our local knowledge of the retirement market with their expertise in pension plan design, investment manager selection and increased due diligence.

BERMUDA REAL ESTATE

BF&M's Bermuda real estate portfolio consists of three main commercial office buildings that we own and occupy in Hamilton. The Insurance Building continues to house the majority of our staff. BF&M has a majority interest in Aon House and in Argo House. Profits from this division in 2012 as in 2011 reflected fully tenanted properties with long term leases.

BERMUDA INTERNATIONAL INSURANCE SERVICES LIMITED

Bermuda International Insurance Services Limited markets and administers life insurance products to high net worth clients in the international marketplace. The need for high death benefit life insurance remains strong, and offers one of the last tax advantaged solutions for many clients globally. Earnings from this company decreased from 2011 due to lower than expected investment performance.

BERMUDA INTERNATIONAL REINSURANCE SERVICES LIMITED

Bermuda International Reinsurance Services Limited contracts with International Reinsurance Managers, LLC (IRM), to underwrite, market and administer health, life and personal accident reinsurance in the Caribbean and Latin American markets. Financial results in 2012 showed a marked improvement over 2011 and were in line with expectations.

PEOPLE AND COMMUNITY

BF&M has a strong Board of Directors, with extensive local and overseas business experience. S. Caesar "Sy" Raboy, a former Senior Vice President & Deputy General Manager, Sun Life Assurance Company of Canada's U.S. Operation, retired in 2012 from BF&M's board. We would like to thank Sy for his wise and valued counsel. We welcomed Ann Teixeira to the Board in June 2012. Ann specializes in advisory services to life insurance companies, and is a Fellow of the Loma Life Institute. She has held multiple senior positions with life insurance companies. David A. J. G. White resigned from the Board in April 2013. David had been a long serving member of the Board, dating back to the incorporation of the BF&M Limited holding company in 1991. We thank him for his years of dedicated service. In addition, Peter Cooper decided not to have the Company put his name forward for re-election at this year's Annual General Meeting. He had also been a member of the Board dating back to the Company's incorporation in 1991. We thank him for his years of loyal service to the Company.

BF&M continued on its path of strong company results over the past year, and much of that is due to our hard working management and staff. This was evidenced by the 20 long service awardees, who between them have given some 275 years of service to the Company; another outstanding service record. We thank them for their dedication and commitment to the Company and the customers we serve.

A number of well-deserved management promotions and additions took place in 2012, as follows: Paul Matthews, Senior Vice President BF&M Life; Miguel DaPonte, Senior Vice President BF&M Investment Services; Patrick Neal, Senior Vice President, Business Development; Andrew Hanwell, Vice President Personal Insurance, BF&M General; Sandra Boden, Assistant Vice President, Policy Administration & Underwriting, BF&M Life. In addition, we were pleased to welcome Mike Rogers, Vice President, Information Technology, to BF&M (Canada).

To keep us on track and in touch with how our employees regard the Company, we conduct bi-annual Employee Opinion Surveys, the most recent one being in November 2012. This provides us with valuable feedback through a confidential vehicle and a way to discuss and set internal policies and goals. BF&M was also proud to have again been selected as one of Bottom Line Magazine's 2012 Top Ten Employers in Bermuda, following a survey conducted by an independent organization. The survey examined which of the island's companies offered the most rewarding work environment and the survey pool of participants grows each year. BF&M continues as an Investor In People Gold award recipient and in continuing our commitment to their standards and the LOMA awards, we are delighted to congratulate the following employees for receiving professional designations in 2012:

Fellow, Life Management Institute
Paul Matthews

Fellow, Academy for Healthcare Management
Paul Matthews

Human Resources Business Professional
Holly Fowler-Hamilton

Fellow, Life Management Institute Level I
Stacey Hayward-Tucker; Kanel Johnson; Clifford Morris; Mark Cabral; Lisa Spencer; Nika Mason; David Coxall

Associate, Reinsurance Administration
Paul Matthews

Associate, Insurance Agency Administration
Paul Matthews

Associate, Customer Service
Paul Matthews; Newton Adcock; Vanessa Brown; Carlyle Simmons; Casey Lopes; Lisa Douglas; Kanel Johnson; Sacha Pedro

Associate, Life Management Institute Level I
Lisa Douglas; Sacha Pedro (Honours); Casey Lopes; Carlyle Simmons; Alex deCampos Guerra; Kanel Johnson (Honours); Clifford Morris (Honours); Kristina Soares (Honours); Thaaqib Talbot

The needs of the Bermuda community continue to grow in our struggling economic times and BF&M operates a targeted approach to our individual donations structure, based mainly on those causes that either align with our business sectors or that are of particular importance to our employees. These are identified through our own endeavours and in conjunction with our local charitable organizations.

We were delighted to be the lead sponsor for our 15th year of the Bermuda Cancer and Health's Breast Cancer Awareness Walk and the associated School Spirit Award. This walk has become a firm October favourite of the community and we were pleased to see so many participants again in Barr's Bay Park, making the program another huge success. The School Spirit Award honors schools who raise the most funds for the walk. Our staff are very passionate about this cause, as almost everyone has been affected in one way or another by breast cancer and many act as volunteers on the day. This gives us a meaningful and measurable way to support the education and research funding needed by the organization.

The Spring training program also continued with our 100 Day Challenge. Many will have seen the entertaining and enlightening television programs from January to April where between 35 to 40 participants compete in teams and individually, to try and lose the most weight and increase their fitness within the 100 days. Participants are given access to trainers, health care experts and nutritionists to enable safe and healthy weight loss and tools to enable them to maintain the loss following the program.

In 2012, we expanded our commitment to youth based programs encompassing the following initiatives: Camp Cardio; The National Inter School Fitness Challenge and the Under 17 Cricket League. Camp Cardio is a program to get children engaged in vigorous extracurricular activities and learn about the importance of a healthy lifestyle. This takes place in July and is open to all middle and senior school students. The National Inter School Fitness Challenge is a 4 week boot camp to get students moving and fit. Fitness levels are tested at the beginning and the end of the challenge to give the students a goal. This program was expanded to include middle schools last year. Two of our initiatives are organized by the Bermuda Cricket Board, namely The Under 17 Cricket League which encourages team participation and constructive activity for our young men. Last year, we were also happy to support the Women's National Cricket Team. Our operations in Barbados, Cayman, and Halifax also participate in local community and charitable causes with great success.

LOOKING FORWARD

The BF&M Group has insurance operations based in Bermuda, Barbados, and Cayman, supported by a very capable group of employees based in Halifax (Canada) that provide support services, mostly related to information technology and finance. The focus for our group in 2013 is operational excellence, working closely together, while recognizing the nuances of each island. We are underwriting insurance in the islands where we currently want to be, with strong and committed management and staff, led by a wealth of experienced boards of directors. Our Company has built up a track record of delivering strong financial results for our shareholders and we are ever confident about maintaining and enhancing this for 2013 and future years.

Gavin R. Arton
Chairman

R. John Wight

R. John Wight, C.A., CPCU
President and Chief Executive Officer


FINANCIAL
STATEMENTS

RESPONSIBILITY FOR FINANCIAL REPORTING
For the year ended 31 December 2012

The management of BF&M Limited ("the Group") is responsible for the preparation of the consolidated financial statements contained in this report. These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards.

Management has established and maintains a system of financial reporting and internal controls to provide reasonable assurance that transactions are properly authorized and recorded. These controls include the careful selection, training, and supervision of qualified employees, the establishment of well-defined responsibilities, and the communication of policies relating to good conduct and business practice. Internal controls are reviewed and evaluated by the Group's internal auditors.

The Audit, Compliance, and Corporate Risk Management Committee, primarily composed of directors who are not officers or employees of the Group, reviews the consolidated financial statements on behalf of the Board of Directors before the statements are submitted to the shareholders.

The shareholders' independent auditors, PricewaterhouseCoopers have examined the consolidated financial statements of the Group in accordance with International Standards on Auditing and have expressed their opinion in their report to the Group's shareholders. The auditors have unrestricted access to and meet periodically with the Audit, Compliance, and Corporate Risk Management Committee to review its findings regarding internal controls over the financial reporting process, auditing matters and reporting issues.

These consolidated financial statements have been authorised for issue by the Board of Directors on 25 April 2013. The Board of Directors has the power to amend these consolidated financial statements after issue, if required.

R. John Wight

R. John Wight, C.A., CPCU
President and Chief Executive Officer

Heather A. Bisbee, C.A.
Head of Financial Reporting

pwc

30 April 2013

Independent Auditor's Report

To the Shareholders of BF&M Limited

We have audited the accompanying consolidated financial statements of BF&M Limited and its subsidiaries, which comprise the consolidated statement of financial position as at 31 December 2012 and the consolidated statement of income, consolidated statement of comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes, comprising a summary of significant accounting policies and other explanatory information.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these 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.

Auditor's 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 about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of BF&M Limited and its subsidiaries, as at 31 December 2012, and their financial performance and their cash flows for the year then ended in accordance with International Financial Reporting Standards.

PricewaterhouseCoopers

Chartered Accountants

PricewaterhouseCoopers, Chartered Accountants, P.O. Box HM 1171, Hamilton HM EX, Bermuda
T: +1 (441) 295 2000, F: +1 (441) 295 1242, www.pwc.com/bermuda

CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
As at 31 December 2012 and 2011
(in thousands of Bermuda dollars)

	Notes	2012 $	2011 $
Assets			
Cash and cash equivalents	8	87,870	75,419
Investments	6	683,008	629,279
Available for sale investments	6	5,101	7,570
Insurance receivables and other assets	9	81,868	54,026
Reinsurance assets	13	73,417	42,853
Deferred policy acquisition costs	10	10,155	2,110
Property and equipment	15	14,298	13,560
Investment properties	16	40,594	41,284
Intangible assets	17	47,795	24,538
Tax recoverable	18	2,549	1,687
Deferred tax asset	18	974	-
Total general fund assets		**1,047,629**	**892,326**
Segregated funds assets	7	478,911	424,886
Total assets		**1,526,540**	**1,317,212**
Liabilities			
Insurance contract liabilities	12	377,645	310,622
Investment contract liabilities	11	317,917	289,577
Other liabilities	19	65,297	42,765
Loans payable	20	25,857	3,715
Retirement benefit obligations	14	7,108	9,748
Deferred tax liability	18	614	427
Total general fund liabilities		794,438	656,854
Segregated funds liabilities	7	478,911	424,886
Total liabilities		**1,273,349**	**1,081,740**
Equity			
Share capital	21	8,477	8,385
Contributed surplus	21	1,482	1,482
Share premium	21	58,484	57,158
Accumulated other comprehensive loss	21	(2,805)	(2,033)
Retained earnings		142,806	128,049
Total shareholders' equity		208,444	193,041
Non-controlling interests		44,747	42,431
Total equity		**253,191**	**235,472**
Total liabilities and equity		**1,526,540**	**1,317,212**

Gavin R. Arton
Chairman

R. John Wight

R. John Wight, C.A., CPCU
President and Chief Executive Officer

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

CONSOLIDATED STATEMENTS OF INCOME
For the years ended 31 December 2012 and 2011
(in thousands of Bermuda dollars except for per share amounts)

	Notes	2012 $	2011 $
INCOME			
Gross premiums written		319,681	233,965
Reinsurance ceded		(142,750)	(67,014)
Net premiums written		176,931	166,951
Net change in unearned premiums	12	2,867	(16)
Net premiums earned		179,798	166,935
Investment income	6	17,236	41,943
Commission and other income	22	47,122	24,297
Rental income		4,108	4,252
Total income		248,264	237,427
EXPENSES			
Insurance contracts benefits and expenses			
Life and health policy benefits	23	105,264	115,360
Short term claim and adjustment expenses	23	18,215	15,708
Investment contract benefits		1,235	9,891
Paid or credited to policyholder accounts		1,120	1,244
Participating policyholders' net (income) loss		(547)	459
Commission expense		25,307	10,573
Operating expenses	24	63,081	49,265
Employee benefit curtailment gain	14	-	(9,629)
Amortization expense		7,071	6,183
Interest on loans		733	180
Total benefits and expenses		**221,479**	**199,234**
Income before income taxes		**26,785**	**38,193**
Income taxes	18	(477)	(1,542)
Net income for the year		**26,308**	**36,651**
Non-controlling interests in subsidiaries		(4,805)	(3,911)
Shareholders' net income		**21,503**	**32,740**
Earnings per share			
- Basic	21	$2.55	$3.91
- Fully diluted	21	$2.55	$3.90

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

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the years ended 31 December 2012 and 2011
(in thousands of Bermuda dollars)

	2012 $	2011 $
Net income for the year after income taxes	26,308	36,651
Other comprehensive income		
Investments classified as available for sale		
Fair value losses	(177)	(381)
Fair value gains transferred to net income on disposal	(436)	(153)
Impairment losses previously revalued through other comprehensive income transferred to net income	(180)	(211)
Unrealized foreign exchange gain (loss) on translation of foreign operations	21	(8)
Total other comprehensive loss for the year after income taxes	(772)	(753)
Comprehensive income	**25,536**	**35,898**
Comprehensive income attributable to:		
Shareholders	20,731	31,987
Non-controlling interests in subsidiaries	4,805	3,911
Comprehensive income	**25,536**	**35,898**

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the years ended 31 December 2012 and 2011
(in thousands of Bermuda dollars)

	Note	Attributable to Shareholders						Non-controlling interest	Total equity
		Share capital $	Contributed surplus $	Share premium $	Accumulated other comprehensive income $	Retained earnings $	Total $	$	$
Year ended 31 December 2012									
At beginning of year		8,385	1,482	57,158	(2,033)	128,049	193,041	42,431	235,472
Comprehensive income for the period									
Net income for the year		-	-	-	-	21,503	21,503	4,805	26,308
Losses on assets held as available for sale		-	-	-	(793)	-	(793)	-	(793)
Currency translation differences		-	-	-	21	-	21	-	21
Total comprehensive income for the year		-	-	-	(772)	21,503	20,731	4,805	25,536
Sub-total		8,385	1,482	57,158	(2,805)	149,552	213,772	47,236	261,008
Transactions with shareholders									
Shares issued under employee share purchase plan	21	12	-	169	-	-	181	-	181
Stock issued under equity incentive plan	21	7	-	59	-	-	66	-	66
Stock grants issued under the equity incentive plan	21	73	-	1,098	-	-	1,171	-	1,171
Cash dividends		-	-	-	-	(6,746)	(6,746)	(2,489)	(9,235)
Total transactions with shareholders		92	-	1,326	-	(6,746)	(5,328)	(2,489)	(7,817)
At end of year		8,477	1,482	58,484	(2,805)	142,806	208,444	44,747	253,191

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

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
For the years ended 31 December 2012 and 2011
(in thousands of Bermuda dollars)

		Attributable to Shareholders							
	Note	Share capital $	Contributed surplus $	Share premium $	Accumulated other comprehensive income $	Retained earnings $	Total $	Non-controlling interest $	Total equity $
Year ended 31 December 2011									
At beginning of year		8,371	1,482	57,032	(1,281)	102,010	167,614	41,431	209,045
Comprehensive income for the period									
Net income for the year		-	-	-	-	32,740	32,740	3,911	36,651
Losses on assets held as available for sale		-	-	-	(744)	-	(744)	-	(744)
Currency translation differences		-	-	-	(8)	-	(8)	-	(8)
Total comprehensive income for the year		-	-	-	(752)	32,740	31,988	3,911	35,899
Sub-total		8,371	1,482	57,032	(2,033)	134,750	199,602	45,342	244,944
Transactions with shareholders									
Shares issued under employee share purchase plan	21	11	-	147	-	-	158	-	158
Stock grants issued under equity incentive plan	21	7	-	42	-	-	49	-	49
Stock grants forfeited under equity incentive plan	21	(4)	-	(63)	-	-	(67)	-	(67)
Cash dividends		-	-	-	-	(6,701)	(6,701)	(2,911)	(9,612)
Total transactions with shareholders		14	-	126	-	(6,701)	(6,561)	(2,911)	(9,472)
At end of year		8,385	1,482	57,158	(2,033)	128,049	193,041	42,431	235,472

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended 31 December 2012 and 2011
(in thousands of Bermuda dollars)

	2012 $	2011 $
Cash flows from operating activities		
Profit before tax	26,785	38,193
Adjustments for:		
Investment income	(24,078)	(24,894)
Change in fair value of investments	(6,209)	(25,652)
Unrealized loss (gain) on investments allocated to insurance contracts	1,422	(995)
Provision for losses on investments	5,293	482
Amortization of property and equipment	1,520	1,302
Amortization of investment properties	930	994
Amortization of intangible assets	4,621	3,158
Impairment of intangible assets	-	729
Gain on sale of property and equipment	(67)	(10)
Interest on loan	733	180
Compensation expense related to shares and options	354	76
Changes in assets and liabilities:		
Insurance receivables and other assets	8,145	(3,087)
Deferred policy acquisition costs	(95)	(142)
Reinsurance assets	156	(10,108)
Insurance contract liabilities	18,130	42,329
Investment contract liabilities	28,341	44,367
Other liabilities	(14,776)	5,995
Retirement benefit obligations	(2,640)	(10,223)
Cash generated from operations	48,565	62,694
Interest paid	(740)	(182)
Income taxes paid	(1,368)	(903)
Interest received	21,313	22,273
Dividends received	476	516
Net cash generated from operating activities	68,246	84,398
Cash flows from investing activities		
Purchase of investments	(267,200)	(290,287)
Proceeds from sales of investments	235,320	219,329
Acquisition of property and equipment	(964)	(773)
Proceeds from sales of property and equipment	67	10
Acquisition of investment properties	(240)	(315)
Acquisition of intangible assets	(2,308)	(3,059)
Acquisition of subsidiary, net of cash acquired	(33,635)	-
Net cash used for investing activities	(68,960)	(75,095)

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

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended 31 December 2012 and 2011
(in thousands of Bermuda dollars)

Cash flows from financing activities		
Cash dividends paid	(6,728)	(6,698)
Loans repaid	(5,859)	(664)
Cash dividends paid to non-controlling interest	(2,489)	(2,919)
Proceeds on issue of common shares	220	123
Proceeds from bank loan	28,000	-
Net cash from (used for) financing activities	13,144	(10,158)
Effect from changes in exchange rates	21	(8)
Increase (decrease) in cash and cash equivalents	12,451	(863)
Cash and cash equivalents - beginning of year	75,419	76,282
Cash and cash equivalents - end of year	**87,870**	**75,419**

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

(in thousands of Bermuda dollars except share and per share amounts)

1. NATURE OF THE GROUP AND ITS BUSINESS

BF&M Limited (the "Group") was incorporated in Bermuda on 5 August 1991, as a holding company, and is a public limited company listed on the Bermuda Stock Exchange. The address of its registered office is: 112 Pitts Bay Road, Pembroke HM08, Bermuda.

On 25 April 2013, the Board of Directors approved the financial statements and authorized them for issue. The Board of Directors has the power to amend the financial statements after issue.

The Group has the following subsidiaries:

	% owned	Principal country of operation and incorporation
BF&M General Insurance Company Limited ("BF&M General")	100	Bermuda
BF&M Life Insurance Company Limited ("BF&M Life")	100	Bermuda
BF&M Properties Limited ("BF&M Properties")	100	Bermuda
Marchmont Insurance Company Limited ("Marchmont")	100	Bermuda
Hamilton Reinsurance Company Limited ("Hamilton")	100	Bermuda
BF&M Investment Services Limited ("BFMISL")	100	Bermuda
Bermuda International Insurance Services Limited ("Bermuda International")	100	Bermuda
Bermuda International Reinsurance Services Limited ("Bermuda International Re")	100	Bermuda
Hamilton Financial Limited ("Hamilton Financial")	100	St. Lucia
Scarborough Property Holdings Limited ("Scarborough")	60	Bermuda
Barr's Bay Properties Limited ("Barr's Bay")	60	Bermuda
Insurance Corporation of Barbados Limited ("ICBL")	51.5	Barbados
Insurance Corporation of Barbados Limited/ National Insurance Board Joint Venture ("ICBLJV")	37.2	Barbados
Island Heritage Holdings, Ltd. ("IHHL")	100	Cayman Islands
BF&M (Canada) Limited ("BF&M Canada")	100	Canada

All subsidiaries have a 31 December year-end.

On 30 March 2012, BF&M Limited acquired 100% of the share capital of Island Heritage Holdings, Ltd., the parent company of a specialty property and casualty insurance group headquartered in the Cayman Islands with insurance operations in several Caribbean islands. The results of the operations have been included in the consolidated statement of income from 30 March 2012. Full details on the acquisition are provided in Note 27.

The Group is involved in property, casualty, motor, marine, life, health and long-term disability insurance, annuities, rent-a-captive services, the management and investment of pension plans, as well as the rental of office space in buildings owned by the Group.

The Group's principal business is insurance. It determines and charges a premium to policyholders which, taken as a pool with all other policyholders, is expected to cover underwriting costs and claims which may take a number of years to settle. The business risks of insurance reside in determining the premium, settlement of claims, and estimation of claim costs and management of investment funds.

To further mitigate underwriting risk, the Group purchases reinsurance to share part of the risks originally accepted by the Group in writing premiums. This reinsurance, however, does not relieve the Group of its primary obligation to policyholders. If any reinsurers are unable to meet their obligations under the related agreements, the Group remains liable to its policyholders for the unrecoverable amounts.

2. SIGNIFICANT ACCOUNTING POLICIES

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

A. BASIS OF PREPARATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") as issued by the International Accounting Standards Board ("IASB").

All amounts in the consolidated financial statements and notes are shown in thousands of Bermuda dollars unless otherwise stated.

Certain prior year amounts have been reclassified to conform to the current year presentation.

B. CONSOLIDATION

i) Subsidiaries

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. ICBL has a 72.35% interest in ICBLJV and as a result fully consolidates ICBLJV in its financial statements. As a result of the control that the Group has on ICBL and by extension ICBLJV, the investment in ICBLJV is fully consolidated in these consolidated financial statements and the interest related to the non-controlling shareholder is accounted for as non-controlling interest. Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date on which control ceases.

The Group uses the acquisition method of accounting to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, including liabilities arising from contingent consideration arrangements. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognized directly in the consolidated statement of income.

Intra-group transactions, balances and gains and losses on intra-group transactions are eliminated. Where subsidiaries' accounting policies are different from the Group, appropriate adjustments have been made to ensure consistency with the policies adopted by the Group.

ii) Transactions with non-controlling interest

The Group applies a policy of treating transactions with non-controlling interests as transactions with parties external to the Group.

C. CRITICAL ESTIMATES AND JUDGEMENTS

The preparation of the Group's consolidated financial statements requires estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses. Estimates and judgements are continually evaluated and based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge and their predictions of future events and actions. Actual results can always differ from those estimates, possibly significantly. Areas where estimates and judgment are exercised by management include insurance and investment contract liabilities, intangible assets, fair value of investments, impairment of assets, retirement benefit obligations, and deferred income taxes. Areas where significant estimates and judgments have been applied by management are described further in the significant accounting policies described below.

D. SEGMENT REPORTING

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker. The chief operating decision-maker, who is responsible for allocating resources and assessing performance of the operating segments, has been identified as the Chief Executive Officer.

E. 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 Bermuda dollars ($), which is the parent company's functional currency.

ii) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognized in the consolidated statement of income.

Translation differences on financial assets and liabilities held at fair value through profit and loss are reported as part of the fair value gain or loss.

iii) Group companies

The results and financial position of all the Group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- Assets and liabilities for each statement of financial position presented are translated at the closing rate at the date of that statement of financial position;
- Income and expenses for each statement of income are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case, income and expenses are translated at the dates of the transactions); and
- All resulting exchange differences are recognized in other comprehensive income.

The exchange rate between Barbadian and Bermudian dollars has essentially remained unchanged since the acquisition of the Barbadian operation in 2005. Cayman Island operation's functional currency is in United States dollars, which are on par with Bermuda dollars. As a result there are no unrealized translation gains and losses to be reported other than for BF&M Canada.

F. PROPERTY AND EQUIPMENT

Property and equipment are stated at historical cost less accumulated depreciation and accumulated impairment losses. Historical cost includes expenditure that is directly attributable to the acquisition of the items.

Land is not depreciated. Depreciation on other assets is calculated using the straight-line method to allocate their cost to their residual values over their estimated useful lives at the following rates:

Buildings	50 years
Furniture and equipment	5 years – 10 years
Computer hardware	3 years – 5 years
Leasehold improvements	the shorter of the lease term or 5 years – 10 years
Motor Vehicles	5 years

The assets' residual values and useful lives are reviewed at the end of each reporting period and adjusted if appropriate. 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.

Gains and losses on disposals are determined by comparing the proceeds with the carrying amount. These are included in the consolidated statement of income.

G. INVESTMENT PROPERTIES

Investment properties are defined as properties held for long-term rental yields or capital appreciation. Properties that do not meet these criteria are classified as property and equipment. Expenditures relating to ongoing maintenance of properties are expensed.

Investment properties comprise freehold land and buildings. Buildings are carried at historical cost less depreciation. Depreciation on buildings is calculated using the straight-line method over 50 years, excluding its residual value.

Fair values for investment properties are determined using the most recently available reports from independent qualified appraisal services. Values are calculated using a weighted value of the following methods: 1) replacement cost approach to estimate the value of the cost to produce buildings of an equivalent function plus market value of the land, less an allowance for depreciation; and 2) income approach to estimate the present value of discounted projected future cash flows using current rental values, assessed rental values or market rental values at a market discount rate.

The assets' residual values and useful lives are reviewed at the end of each reporting period and adjusted if appropriate. 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.

H. INTANGIBLE ASSETS

Intangible assets include goodwill, indefinite life and finite life intangible assets. Intangible assets are tested for impairment on an annual basis and if determined to be impaired, a charge is recorded in earnings to the extent the carrying value exceeds the recoverable amount, which is the higher of value in use and fair value less costs to sell. The estimated life is re-evaluated annually. These assets include the following:

(i) Goodwill

Goodwill represents the excess of the acquisition cost over the fair value of the Group's proportionate share of the net identifiable assets of an acquired business at the acquisition date. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is assessed for impairment annually or more frequently if events or circumstances occur that may indicate that the carrying amounts may not be recoverable at the cash generating unit ("CGU"), which in this case are the acquired businesses, ICBL and IHHL on an individual basis.

(ii) Indefinite life intangible assets

The ICBL brand is recorded at historical cost and was determined to have an indefinite life because there is no foreseeable limit to the cash flows generated by these intangible assets. Indefinite life intangible assets are not amortized. Impairment of this asset is assessed on an annual basis or more frequently if events or circumstances occur that may indicate that the carrying amounts may not be recoverable.

(iii) Finite life intangible assets

Intangible assets that were determined to have finite lives are amortized on a straight line basis over varying periods of up to 10 years, being the estimated expected lives. The estimated life is re-evaluated annually. These assets include the following:

Customer relationships and contracts

These assets, which comprise customer lists, customer relationships and contracts acquired from the purchase of rights or as part of business combinations, were initially measured at fair value by estimating the net present value of future cash flows from the contracts in force at the date of acquisition. These assets are amortized over 10 years, being the expected life of the business assumed.

Distribution channel

These assets, which comprise agent and bank relationships acquired as part of the business combination with IHHL, were initially measured at fair value by estimating the net present value of future cash flows from these relationships based on a historical ratio of 90% of gross written premium arising from this distribution channel on business in force at the date of acquisition. These assets are amortized over 10 years, being the expected life of the business assumed and the business channel relationship.

IHHL brand
The IHHL brand acquired in the business combination was initially measured at fair value based on the relief of royalty method at the date of acquisition. These assets are amortized over 5 years, based on the expected timing of a potential re-branding strategy for this business.

Software development costs
Software development costs that are directly attributable to the design and testing of identifiable software products controlled by the Group are recognized as intangible assets when:

- it is technically feasible to complete the software product so that it will be available for use;
- management intends to complete the software product and use it;
- there is an ability to use the software product;
- it can be demonstrated how the software product will generate probable future economic benefits;
- adequate technical, financial and other resources to complete the development and to use the software product are available; and
- the expenditure attributable to the software product during its development can be reliably measured.

Directly attributable costs that are capitalized as part of the software development include employee costs and an appropriate portion of directly attributable overheads. Other development expenditures that do not meet these criteria are expensed when incurred. Capitalized software development costs are amortized over their useful lives, which range from 5 to 10 years.

I. FINANCIAL ASSETS
The Group classifies its investments into the following categories: financial assets at fair value through profit and loss ("FVTPL"), loans and receivables, and financial assets available for sale. The classification is determined by management at initial recognition and depends on the nature of the assets and the purpose for which the assets were acquired.

Recognition and measurement
Financial assets at FVTPL are financial assets that have been designated on initial recognition as FVTPL or have been acquired principally for the purpose of selling in the short term or held for trading. Purchases and sales of investments are recognized on trade-date at fair value. Financial assets at FVTPL are subsequently carried at fair value. Estimated fair value is determined based on bid prices from recognized exchanges, broker-dealers or using valuation techniques derived from observable data in respect of similar financial instruments. Gains and losses arising from changes in the fair value of the financial assets FVTPL are included in the consolidated statement of income in the period in which they arise.

Loans and receivables are all non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and are recognized at trade-date at fair value plus transaction costs. Loans and receivables are carried at amortized cost using the effective interest method.

Financial assets available for sale are non-derivatives that are either designated in this category or not classified in any of the other categories and are recognized on trade-date at fair value plus transaction costs. Properties available for sale are carried at the lower of carrying value and the estimated fair value less costs to sell and other available for sale financial assets are subsequently carried at fair value. The estimated fair value on other assets is determined based on bid prices from recognized exchanges, broker-dealers or using valuation techniques derived from observable data in respect of similar financial instruments. Gains and losses arising from changes in the fair value of the financial assets available for sale are included in the consolidated statement of comprehensive income in the period in which they arise. When securities classified as available for sale are sold or impaired, the accumulated fair value adjustments recognized in equity are included in the consolidated statement of income.

Dividends on equity instruments are recognized in the consolidated statement of income on the ex-dividend date. Other investment income is recorded on the accruals basis.

Investments are derecognized when the Group has transferred substantially all risks and rewards of ownership.

J. IMPAIRMENT OF ASSETS

i) Financial assets carried at amortized cost

The Group reviews the carrying value of its loans and receivables at each period end for evidence of impairment. A loan or receivable is impaired if its carrying value exceeds the estimated fair value and there is objective evidence of impairment. Such evidence includes failure to make scheduled payments of capital and/or interest, adverse changes in the payment pattern of the borrower and a significant deterioration in the fair value of the security underlying the loan.

If there is objective evidence that an impairment loss has been incurred on loans and receivables carried at amortized cost, 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 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 recognized in the consolidated statement of income.

ii) Financial assets classified as available for sale

In the case of equity financial assets classified as available for sale, in addition to types of events listed above, a significant or prolonged decline in the fair value of the security below its cost is objective evidence of impairment.

The cumulative loss, measured as the difference between the acquisition cost and the current fair value less any impairment loss on that financial asset previously recognized in other comprehensive income, is removed from equity and recognized in the consolidated statement of income.

iii) Impairment of other non-financial assets

Assets that have an indefinite useful life are not subject to amortization and are tested annually for impairment. Assets that are subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

K. CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash in hand, deposits held on call with banks, other short-term highly liquid financial assets with original maturities of three months or less, and bank overdrafts. Regulatory deposits held with Regulators as a legal requirement in order to provide services in the respective territories, which can at times have maturity longer than three months due to regulatory requirements, have also been classified as cash and cash equivalents. The carrying value of cash and cash equivalents approximates their fair value.

L. SEGREGATED FUNDS

Segregated funds are contracts issued by the Group where the benefit amount to the policyholder is directly linked to the fair value of the investment held in the particular segregated funds. The underlying assets are registered in the name of the Group and the segregated fund policyholder has no direct access to the specific assets. The contractual arrangements are such that the segregated fund policyholder bears the risk and rewards of the fund's investment performance. There is also no insurance risk to the Group with these contracts. Segregated funds net assets are recorded at fair value. The fair value of the segregated funds net liabilities is equal to the segregated funds net assets. Income earned on the management of these contracts is included in commission and other income within the consolidated statements of income. Investment income earned by the segregated funds and expenses incurred by the segregated funds are not presented in the consolidated statements of income and are disclosed in note 7.

In 2011, segregated funds include the assets and liabilities for rent-a-captive segregated accounts. These are funding contracts which are arranged by the Group in accordance with a Private Act and comprise the cumulative excess of premiums received and interest allocated to the accounts over the repayment of premiums, losses and loss expenses. Assets for these accounts are segregated and invested in accordance with the terms of the underlying policy agreements and are only available to settle the corresponding segregated account liabilities. In 2012, the rent-a-captive segregated accounts were closed and remaining net assets returned to policyholders.

M. FINANCIAL LIABILITIES

Financial liabilities include insurance and investment contracts, other liabilities, loans payable and retirement benefit obligations. Other liabilities and loans payable are initially recorded on the consolidated statement of financial position at fair value and subsequently carried at amortized cost using the effective interest rate method with amortization expense recorded in the consolidated statement of income.

N. INSURANCE AND INVESTMENT CONTRACT CLASSIFICATION

The Group issues contracts that transfer insurance risk or financial risk or both.

Insurance contracts are those contracts where the Group (the insurer) has accepted significant insurance risk from another party, the policyholder or ceding company, by agreeing to compensate the policyholders if a specified uncertain future event (the insured event) adversely affects the policyholders. As a general guideline, the Group determines whether it has significant insurance risk, by comparing benefits paid with benefits payable if the insured event did not occur. In addition, the Group considers the proportion of premiums received to the benefit payable if the insured event did occur. Insurance contracts can also transfer financial risk.

Investment contracts are those contracts that do not transfer significant insurance risk but do transfer financial risk from the policyholder.

Contracts issued that do not transfer significant insurance or financial risk from the policyholder are referred to as service contracts.

Once a contract has been classified as an insurance contract, it remains an insurance contract for the remainder of its lifetime, even if the insurance risk reduces significantly during this period, unless all rights and obligations are extinguished or expire. Investment contracts can, however, be reclassified as insurance contracts after inception if insurance risk becomes significant.

The Group issues contracts that in some instances contain a discretionary participation feature (DPF). This feature entitles the holder to receive, as a supplement to guaranteed benefits, a dividend. Dividends are paid on the policy anniversary and as long as the policy is in force. These contracts are referred to as participating contracts. IFRS allows the non-guaranteed, or participating, elements of such contracts to be classified as either a liability or as equity, depending on the nature of our obligation to the policyholder. The contracts issued by the Group contain constructive obligations to the policyholder with respect to the DPF of the contracts. We have therefore elected to classify these features as a liability, consistent with accounting treatment under the Canadian Asset Liability Method (“CALM”), and in accordance with guidance provided by the Canadian Institute of Actuaries.

Investment contracts with discretionary participating features are accounted for in accordance with IFRS 4 and investment contracts without discretionary participating features are accounted for in accordance with *IAS 39, Financial Instruments: Recognition and Measurement*. The Group has not classified any contracts as investment contracts with discretionary participating features.

Life and health insurance contracts include term, whole life and universal life insurance contracts, group life insurance policies, health insurance contracts and life contingent annuities. The Group holds whole life contracts which may be either participating or non-participating contracts.

Short-term insurance contracts include property, casualty, motor, marine and other specialty insurance contracts. These contracts are all non-participating contracts.

O. INSURANCE CONTRACT LIABILITIES

(i) Life and health insurance contracts

These contracts (meaning insurance contract liabilities, both participating and non-participating) include all forms of life, health and accident insurance and life contingent annuities sold to individuals and groups. A provision for life and health insurance liabilities is made which represents the amounts required, in addition to future premiums and investment income, to provide for future benefit payments, policyholder dividends, commission and policy administrative expenses for all in-force life insurance and annuity policies. These benefits are determined using generally accepted actuarial practices according to standards established by the Canadian Actuarial Standards Board (“ASB”). In accordance with these standards, the provisions have been determined using the CALM or an approximation of CALM.

The insurance liabilities under CALM are calculated by projecting asset and liability cash flows under a variety of interest rate scenarios using best estimate assumptions, together with margins for adverse deviations with respect to other contingencies pertinent to the valuation. Long term business provisions make sufficient allowance for the expected experience scenario and for adverse deviations in experience. Liabilities derived through an approximation to CALM rely on a combination of Group and industry specific experience in order to determine the best estimate assumptions and corresponding margins for adverse deviations, the largest of which, the group and individual health reserves, relies on a 5 year historical analysis of the Group's claims emergence patterns and completion factors. Many of the estimates used in actuarial valuation relate to future events and involve a significant amount of judgment. As a result, these estimates are subject to revision on a regular basis.

In certain life and health reinsurance contracts underwritten by Bermuda International Re, where the timeliness and quality of information from cedants is not sufficient to provide a reasonable estimate of true premium written, then those premiums are recorded as cash is received from the cedants. An insurance contract liability is calculated and any loss on an underwriting year is recorded in the consolidated statement of income. If any profit is anticipated on an underwriting year then further reserves are established to record to nil underwriting income. This takes place for the first 3 years of each underwriting year program as this time period is felt to be the minimum time necessary to determine underwriting results.

Expected reinsurance recoveries, net of any required provision for impairment are estimated using principles consistent with the Group's method for establishing the related liability and are recorded in accordance with the terms of the Group's reinsurance agreements.

(ii) Short-term insurance contracts

Claims and loss adjustment expenses are charged to insurance contract benefits and expenses within the consolidated statement of income as incurred based on the estimated ultimate liability for compensation owed to contract holders or third parties damaged by the contract holders. They include direct and indirect claims settlement costs and arise from events that have occurred up to the end of the reporting period even if they have not yet been reported to the Group. The Group does not discount its liabilities for unpaid claims.

A provision for short-term insurance liabilities is made for the estimated costs of claims notified but not settled at the balance sheet date, using the best information available at that time. In addition to development on known claims, a provision is included for losses and loss adjustment expenses incurred but not reported on the basis of past experience. The provision is based on an actuarial analysis of the Group's underwriting year or accident year development experience. The provision is determined using generally accepted actuarial practices in Canada or the United States. The method of making such estimates and for establishing the resulting provisions is reviewed and updated annually and any adjustments resulting therefrom are reflected in earnings in the period in which they are determined.

Expected reinsurance recoveries on claims, net of any required provision for doubtful amounts, are estimated using principles consistent with the Group's method for establishing the related liability, and are in accordance with the terms of the Group's reinsurance agreements.

(iii) Embedded derivatives

The Group separately measures embedded derivatives that meet the definition of an insurance contract or embedded options to surrender insurance contracts for a fixed amount (or an amount based on a fixed amount and an interest rate).

(iv) Liability adequacy test

At each end of the reporting period, liability adequacy tests are performed on short-term insurance contracts to ensure the adequacy of the contract liabilities net of related deferred policy acquisition costs ("DAC"). In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses, as well as investment income from the assets backing such liabilities, are used. Any deficiency is immediately charged to the consolidated statement of income initially by writing off DAC and by subsequently establishing a provision for losses arising from liability adequacy tests (the unexpired risk provision). Any DAC written off as a result of this test cannot subsequently be reinstated.

(v) Deferred policy acquisition costs ("DAC")

For short term insurance contracts, commissions and other acquisition costs that vary with and are related to securing new contracts and renewing existing contracts are capitalised. All other costs are recognized as expenses when incurred. The DAC is subsequently amortized over the term of the policies as premium is earned.

(vi) Loans to policyholders

Loans to policyholders are initially measured at fair value and subsequently carried at amortized cost and are fully secured by the policy values on which the loans are made. These loans are classified as loans and included in investments within the consolidated statement of financial position.

P. INVESTMENT CONTRACT LIABILITIES

The Group's investment contracts include pension plans with a guaranteed minimum rate of return and annuities that do not transfer insurance risk. All investment contracts issued are non-participating.

Liabilities for investment contracts are measured at fair value through profit and loss ("FVTPL") except for certain annuity products measured at amortized cost. Contracts recorded at FVTPL are measured at fair value at inception and each subsequent reporting period using CALM or an approximation of CALM. Contracts recorded at amortized cost are initially recorded at fair value and remeasured at amortized cost in each subsequent period using the effective interest rate. Changes in investment contract liabilities are recorded as a change in investment contract benefits expense within the consolidated statement of income. These liabilities are derecognized when the obligation of the contract is discharged, cancelled or expired.

Q. REINSURANCE CONTRACTS HELD

The Group uses reinsurance in the normal course of business to manage its risk exposure. Contracts entered into by the Group with reinsurers, under which the Group is compensated by the reinsurers for losses on one or more contracts issued by the Group and that meet the classification requirements for insurance contracts, are classified as reinsurance contracts held.

The benefits to which the Group is entitled under its reinsurance contracts held are recognized as reinsurance assets. These assets consist of short-term balances due from reinsurers, as well as longer term receivables that are dependent on the expected claims and benefits arising under the related reinsured insurance contracts. Amounts recoverable from or due to reinsurers are measured consistently with the underlying insurance contracts and in accordance with the terms of each reinsurance contract. Reinsurance liabilities are primarily premiums payable for reinsurance contracts and are amortized consistent with the underlying insurance contracts.

The Group assesses its reinsurance assets for impairment on an annual basis. If there is objective evidence that the reinsurance asset is impaired, the Group reduces the carrying amount of the reinsurance asset to its estimated recoverable amount and recognizes that impairment loss in the consolidated statement of income.

R. RECEIVABLES AND PAYABLES RELATED TO INSURANCE CONTRACTS AND INVESTMENT CONTRACTS

Receivables and payables are recognized when due. These include amounts due to and from agents, brokers and insurance and investment contract holders. These receivables and payables are included in insurance receivables and other assets, insurance and investment contract liabilities and other liabilities within the consolidated statement of financial position.

If there is objective evidence that the receivable is impaired, the Group reduces the carrying amount of the receivable accordingly and recognizes that impairment loss in the consolidated statement of income. The Group gathers the objective evidence that a receivable is impaired using the same process adopted for loans and receivables in Note 2J (i) above. The impairment loss is calculated using the same method used for these financial assets.

S. CURRENT AND DEFERRED INCOME TAX

The tax expense for the period on the Group's Barbados, Canadian and Cayman Islands operations comprises current and deferred tax. Tax is recognized in the consolidated statement of income, except to the extent that it relates to items recognized in the consolidated statement of comprehensive income.

The current income tax charge is calculated on the basis of the tax laws enacted or substantively enacted at the end of the reporting period in the countries where the Group's subsidiaries operate and generate taxable income.

Deferred income tax is recognized, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantively enacted by the end of the reporting period and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognized to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilized.

The tax effects of carry-forwards of unused losses or unused tax credits are recognized as an asset when it is probable that future taxable profits will be available against which these losses can be utilized.

T. EMPLOYEE BENEFITS

i) Pension obligations

The liability recognized in the consolidated statement of financial position in respect of the defined benefit pension plan is the present value of the defined benefit obligation at the end of the financial reporting period less the fair value of plan assets, together with adjustments for unrecognized actuarial gains or losses. The defined benefit obligation is calculated annually by independent actuaries. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using market interest rates of high-quality debt instruments. Annual changes in net assets or obligations arising from plan amendments and transitional amounts are amortized over the expected average remaining service life of the employees covered by the plan.

Actuarial gains and losses arise from experience adjustments and changes in actuarial assumptions. Actuarial gains and losses that are in excess of 10% of the greater of the benefit obligation and the fair value of plan assets are amortized over the average remaining service period of active employees.

With respect to the Group's defined contribution plans, the Group pays contributions into the plan and has no further payment obligations once the contributions have been paid. The contributions are recognized as employee benefit expenses when they are due.

ii) Other post-employment obligations

In addition to pension benefits, the Group provides post-retirement benefits for health care to qualified Bermuda retirees and employees in Barbados. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment using an accounting methodology similar to that for defined benefit pension plans.

These costs are recognized on an accrual basis during the years when service is provided to the Group, except for the 2012 Bermuda retiree plan where only the interest on the obligation is recognized in the consolidated statement of comprehensive income. Annual changes in the post-retirement benefits for health care obligations arising from plan amendments are amortized on a straight-line basis over the expected average remaining service life to full eligibility age of employees covered by the plan. Actuarial gains and losses that are in excess of 10% of the benefit obligation are amortized over the average remaining service period of active employees. Independent qualified actuaries value these obligations annually.

iii) Share-based compensation

The Group has an Equity Incentive Plan which is described in Note 21. Stock grants are issued to employees equal to the fair value of the shares on the grant date. The amount of the benefit of these shares grants is amortized over the vesting period as operating expense within the consolidated statement of income.

If the Group grants share options to employees that vest in the future if they are still employed, then the fair value of the options will be calculated at the date the options are granted. This fair value will be charged to the consolidated statement of income equally over the vesting period with adjustments made at each accounting date to reflect the best estimate of the number of options that will eventually vest.

iv) Employee share purchase plan

The Group operates an employee share purchase plan that allows its employees to purchase the Group's common shares at below-market rates, subject to certain restrictions. Shares are offered at a discount to the shares' fair market value, as determined by the market share price on the date of purchase. Employees may purchase shares up to a maximum percentage of their gross salary. The discount is charged to compensation expense in the period in which the shares are purchased.

U. REVENUE RECOGNITION

Revenue comprises the fair value for services. Revenue is recognized as follows:

(i) Premium income

Premiums on most life and health insurance contracts and life contingent annuity investment contracts are recognized as revenue when due from the policyholder.

Premiums on life and health reinsurance contracts underwritten by Bermuda International Re are recognized based on receipts reported by the ceding company. This occurs when the timeliness and quality of information reported is not sufficient to otherwise record the revenue when due.

Contributions received on non-participating investment contracts and certain long-term insurance contracts within Bermuda International are treated as policyholder deposits and not recorded as revenue in the consolidated statement of income. Only those contributions used to cover insured risk and associated costs are treated as premium income. These include fees for the cost of insurance and administrative charges.

For short-term insurance products, premiums written are earned on a pro-rata basis over the terms of the policies to which they are related. Unearned premiums represent the portion of premiums written that relate to the period of risk subsequent to the year-end. Unearned premiums are included as a component of insurance contract liabilities within the consolidated statement of financial position.

(ii) Commission income

For short-term reinsurance contracts, commission income is recognized over the term of the related reinsurance contracts and in accordance with the expensing of the related reinsurance premiums. Commission income on long-term insurance contracts is recognized when earned and the amount is readily determinable. The recognition of profit commissions is also dependent on the loss experience underlying such reinsurance policies.

(iii) Service contracts

Revenue arising from the management of service contracts, pension administrative services, rent-a-captive services and investment advisory and management offered by the Group is recognized in the accounting period in which the services are rendered. This revenue is included within commission and other income in the consolidated statement of income.

V. LEASES

The Group leases investment properties. A significant portion of the risks and rewards of ownership are retained by the Group as the lessor. These leases are therefore classified as operating leases. Lease arrangements are fixed and the tenant can renew their lease when their tenancy is nearing expiry. There are no contingent rentals included in the lease agreements.

Revenue under operating leases is recognized in the consolidated statement of income as rental income over the lease term.

3. NEW AND REVISED ACCOUNTING STANDARDS

A. AMENDED INTERNATIONAL FINANCIAL REPORTING STANDARDS ADOPTED IN 2012

The following amendments to existing standards were issued by the IASB and adopted by the Group in the current year.

IFRS 7 Financial Instruments: Disclosures ("IFRS 7") was amended to revise the disclosures related to transfers of financial assets. The revised disclosures will help users of financial statements evaluate the risk exposures relating to transfers of financial assets and the effect of those risks on an entity's financial position and provide transparency in the reporting of these transactions, particularly those that involve securitization of financial assets. The adoption of these amendments did not have a material impact on the Group's financial statements.

None of the other new standards, interpretations and amendments, which are effective for the Group's accounting period beginning after January 1, 2012 are relevant to the Group's financial statements.

B. AMENDED AND NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS TO BE ADOPTED IN 2013

The following new standards and amendments to existing standards issued by the IASB will be adopted by the Group in 2013.

IFRS 10 - Consolidated Financial Statements ("IFRS 10") defines the principle of control, establishes control as the basis for determining which entities are consolidated, and sets out the requirements for the preparation of consolidated financial statements. Under the standard, an investor controls an investee when it has power over the investee, exposure or rights to variable returns from its involvement with the investee, and the ability to use its power over the investee to affect the amount of the investor's returns. IFRS 10 is effective for annual periods beginning on or after January 1, 2013. These amendments are not expected to have an impact on the Group's financial statements.

IFRS 11 - Joint Arrangements ("IFRS 11") requires a party to a joint arrangement to determine the type of arrangement in which it is involved by assessing its rights and obligations from the arrangement. It eliminates the option to use the proportionate consolidation method for joint ventures and requires that the equity method be applied to account for our investment in these entities. This standard is effective for annual periods beginning on or after January 1, 2013. We are currently assessing the impact the adoption of these amendments will have on the Group's financial statements.

IFRS 12 - Disclosure of Interests in Other Entities ("IFRS 12") proposes new disclosure requirements for all entities that have an interest in a subsidiary, a joint arrangement, an associate or an unconsolidated structured entity. IFRS 12 requires that an entity disclose information that enables users of financial statements to evaluate the nature of, and risks associated with, its interests in other entities and to evaluate the effects of those interests on its financial position, financial performance and cash flows. These disclosures will be included in the Group's 2013 financial statements.

Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance (Amendments to IFRS 10, IFRS 11 and IFRS 12). The amendments clarify the transition guidance in IFRS 10 and provide transitional relief for IFRS 10, IFRS 11 and IFRS 12 by limiting the comparative information requirements to only the preceding comparative period. The effective date of these amendments is January 1, 2013, consistent with IFRS 10, 11 and 12 and we will apply these amendments when we adopt those standards in 2013.

As a result of the issuance of IFRS 10, IFRS 11 and IFRS 12, both the current *IAS 27 Separate Financial Statements* ("IAS 27") and *IAS 28 Investments in Associates* ("IAS 28") were amended. The requirements related to separate financial statements will remain in IAS 27 while the requirements related to consolidated financial statements are replaced by IFRS 10. The amendments are effective for annual periods beginning on or after January 1, 2013. The amendments to IAS 27 and IAS 28 are not expected to have a material impact on our consolidated financial statements.

IFRS - 13 Fair Value Measurement ("IFRS 13") defines fair value and sets out a single framework for measuring fair value when fair value is required by other IFRS standards. It also requires disclosures about fair value measurements and expands fair value disclosures to include non-financial assets. This standard is effective for quarterly and annual periods beginning on or after January 1, 2013. The adoption of IFRS 13 will result in additional disclosures but is not expected impact the financial results of the Group.

IAS 19 - Employee Benefits ("IAS 19") was amended. Under the amended standard, actuarial gains and losses will no longer be deferred or recognized in profit or loss, but will be recognized immediately in other comprehensive income. Past service costs will be recognized in the period of a plan amendment and the annual expense for a funded plan will include net interest expense or income using the discount rate applied to the net defined benefit asset or liability. The amendments also require changes to the presentation in the consolidated financial statements and enhanced disclosures for defined benefit plans. This amended standard is effective for annual periods beginning on or after January 1, 2013. The Group is yet to assess the full impact of the amendments.

IAS 1 - Presentation of Financial Statements ("IAS 1") was amended regarding the presentation of items in other comprehensive income ("OCI"). The amendments require separate presentation within OCI of items that are potentially reclassifiable to profit or loss subsequently and those that will not be reclassified to profit or loss. The amendments are effective for annual periods beginning on or after July 1, 2012. IFRS 7 amendments were issued which require additional disclosures about the effects of offsetting financial assets and financial liabilities and related arrangements. The new disclosures will require entities to disclose gross amounts subject to rights of set off, amounts set off, and the related net credit exposure. The disclosures are intended to help investors understand the effect or potential effect of offsetting arrangements on a company's financial position. The new disclosures are effective for annual periods beginning on or after January 1, 2013. We do not expect the adoption of these amendments to have a significant impact on the Group's financial statements.

IAS 27 - Separate Financial Statements ("IAS 27") was amended in 2011 by IFRS 10 above. It outlines the accounting and disclosure requirements for 'separate financial statements', which are financial statements prepared by a parent, or an investor in a joint venture or associate, where those investments are accounted for either at cost or in accordance with *IFRS 9 Financial Instruments* ("IFRS 9"). IAS 27 as amended is effective for annual periods beginning on or after January 1, 2013. These amendments are not expected to have an impact on the Group's financial statements.

Annual Improvements 2009-2011 Cycle was issued and includes amendments to five IFRSs. The annual improvements process is used to make necessary but non-urgent changes to IFRS that are not included as part of any other project. The amendments clarify guidance and wording or make relatively minor amendments to the standards that address unintended consequences, conflicts or oversights. The amendments issued as part of this cycle must be applied retrospectively and are effective for annual periods beginning on or after January 1, 2013. We do not expect the adoption of these amendments to have a significant impact on the Group's financial statements.

C. AMENDED AND NEW INTERNATIONAL FINANCIAL REPORTING STANDARDS TO BE ADOPTED IN 2014 OR LATER
The following new standards and amendments to existing standards were issued by the IASB and are expected to be adopted by the Group in 2014 or later.

IAS 32 - Financial Instruments: Presentation ("IAS 32") amendments were issued to clarify the existing requirements for offsetting financial assets and financial liabilities. The amendments are effective for annual periods beginning on or after January 1, 2014. We are currently assessing the impact the adoption of these amendments will have on the Group's financial statements.

IFRS 9 - Financial Instruments ("IFRS 9") requires financial assets to be measured at fair value or amortized cost while eliminating the existing categories of Available For Sale, Held To Maturity and Loans and receivables. It also changes the accounting for financial liabilities measured using the fair value option. The effective date is for annual periods beginning after January 1, 2015. The amendments also provide relief from the requirements to restate comparative financial statements. The Group is currently assessing the impact of IFRS 9.

4. MANAGEMENT OF FINANCIAL AND INSURANCE RISK

Risk management and objectives
The Group's primary objective in undertaking risk management activity is to manage risk exposures in line with risk appetite, minimizing its exposure to unexpected financial loss and limiting the potential for deviation from anticipated outcomes. In this respect, a framework of limits and qualitative statements, aligned with the Group's risk appetite, is in place for material exposures. Key management recognizes the critical importance of having efficient and effective risk management systems in place.

A significant part of the Group's business involves the acceptance and management of risk. The Group is exposed to insurance, market, credit, liquidity and operational risks and operates a formal risk management framework to ensure that all significant risks are identified and managed.

The Group seeks to manage its exposures to risk through control techniques which ensure that the residual risk exposures are within acceptable tolerances agreed by the Board of Directors. The Group has established a risk management function with terms of reference from the Board of Directors, its committees and the associated executive management committees. This is supplemented with an organizational structure with documented delegated authorities and responsibilities from the Board of Directors to executive management committees and senior managers. The key control techniques for the major categories of risk exposure are summarized in the following sections.

Risks are usually grouped by risk type: financial, including credit, liquidity and market, and insurance, including life and health insurance and short term insurance risk. Risks falling within these types may affect a number of key metrics including those relating to balance sheet strength, liquidity and profit. The risk factors mentioned below should not be regarded as a complete and comprehensive statement of all potential risks and uncertainties.

Assets which relate to certain life insurance and investment contracts are managed for the account and risk of the Group's customers. They are segregated and managed to meet specific investment objectives of the policyholders. The assets back the insurance liabilities and the financial liabilities arising from these contracts. The fair value of the liabilities reflects the fair value of the assets. The assets and liabilities from segregated account and private placement life insurance are excluded from the Group's financial risk management considerations to the extent that the risks are borne by the customers.

A. FINANCIAL RISKS

i) Credit risk

Credit risk is the exposure that a counter-party to a financial instrument is unable to meet an obligation, thereby causing a financial loss to the Group. The following policies and procedures are in place to manage this risk:

- Holding a diversified investment portfolio that focuses on quality of investment. The portfolio is monitored and reviewed regularly by management's Investment Committee and by the Board of Director's Finance, Compensation, and Corporate Governance Committee;
- Investment guidelines are in place that require the purchase of only investment-grade assets and minimize undue concentration of assets in any single group, asset class or credit rating;
- Investment guidelines specify collateral requirements for mortgages and loans and receivables which include the underlying property or other security; and
- Transacting business with well-established reinsurance companies with strong credit ratings. All major reinsurers are rated A- or better with A.M. Best.

The Group faces credit risk on its financial assets.

(in thousands of Bermuda dollars except share and per share amounts)

Maximum exposure to credit risk – Financial assets

The following table summarises the Group's maximum exposure to credit risk related to financial assets. The maximum credit exposure is the carrying value of the asset net of any allowances for losses.

	2012 $	2011 $
Cash and short-term deposits	87,870	75,419
Investments	683,008	629,279
Available for sale investments	5,101	7,570
Insurance receivables and other assets	81,868	54,026
Reinsurance assets	73,417	42,853
	931,264	**809,147**

Concentration of credit risk

Concentrations of credit risk arise from exposures to a single debtor, a group of related debtors or groups of debtors that have similar credit risk characteristics in that they operate in the same geographic region or in similar industries.

The following table provides details of the carrying value of bonds by industry sector and geographic distribution:

	2012 $	2011 $
Bonds issued or guaranteed by:		
Financials	97,900	80,542
Government	111,541	113,846
U.S. Treasury and other agencies	173,324	159,557
Utilities and energy	61,861	52,576
Consumer staples and discretionary	54,095	48,586
Telecom	13,508	11,755
Computer technology products and services	14,253	12,374
Industrials	17,945	12,662
Other	15,671	16,908
Total bonds	**560,098**	**508,806**
United States	352,902	328,327
Barbados	110,175	108,560
Canada	47,748	35,574
Northern Europe	24,034	17,727
Asia-Pacific	11,485	6,294
United Kingdom	7,274	4,053
Caribbean	3,616	3,985
Other	2,864	4,286
Total bonds	**560,098**	**508,806**

(in thousands of Bermuda dollars except share and per share amounts)

The carrying value of mortgages and loans by geographic location is shown in the following table:

	2012 $	2011 $
Bermuda	93,998	93,242
Barbados	4,119	4,109
Total mortgages and loans	**98,117**	**97,351**

Credit quality of bonds

	2012 $	2011 $
Bonds		
AAA	38,192	43,330
AA	229,660	198,111
A	164,704	133,812
BBB	28,625	98,557
BB and lower	83,674	-
Not rated*	15,243	34,996
Total bonds	**560,098**	**508,806**

*Not rated bonds relate to assets held within the Group's investment portfolio which are held by counterparties that are not rated by the rating agencies.

Mortgages and loans credit risk

Mortgages comprise first mortgages on real property situated in Bermuda and Barbados. Bermuda mortgages are registered under The Mortgage Registration Act 1976 and The Trustee Act 1975. Loans provided to companies are secured by a certificate of annual repayment of principal and interest by the Barbados National Bank. Other loans are secured by a collateral assignment of life insurance policy proceeds and irrevocable beneficiary designation.

Mortgages and loans that are past due but not considered impaired are loans for which scheduled payments have not been received, but management has reasonable assurance of collection of the full amount of principal and interest due.

The following table provides carrying amounts of the loans by their aging profile:

	2012 $	2011 $
Not past due	73,838	75,307
Past due but not impaired:		
Past due less than 90 days	10,766	10,394
Past due 90 to 180 days		3,432
Past due 180 days or more	1,917	1,339
Impaired (net of impairment provisions)	11,596	6,879
Total mortgages and loans	**98,117**	**97,351**

(in thousands of Bermuda dollars except share and per share amounts)

The reconciliation of the impairment and provision on mortgage and loans is as follows:

	2012 $	2011 $
At 1 January	907	570
Increase in impairment and provision allowances	5,012	337
At 31 December	**5,919**	**907**

ii) Liquidity risk

Liquidity risk is the risk that the Group will encounter difficulty in meeting obligations as they become due. In order to manage liquidity risks, management maintains levels of cash and short-term deposits, which are sufficient to fulfill the Group's short-term obligations. The Group also closely manages operating liquidity through cash flow matching of assets and liabilities on its life insurance, annuities and pensions business.

A significant business objective of the insurance industry is to match the cash flows of the investment portfolio with the expected payment of policy liabilities.

The maturity profile of investments at 31 December 2012 is as follows:

	Within 1 year $	2 to 3 years $	4 to 5 years $	Over 5 years $	Total $	Effective interest rate ranges
Bonds	63,898	110,665	197,283	188,252	560,098	0.13%-10.75%
Mortgages	10,423	11,602	5,969	62,292	90,286	2.70%-9.00%
Policyholder loans	692	384	384	2,884	4,344	4.75%-8.25%
Corporate loans	3,487	-	-	-	3,487	1.86%-2.36%
	78,500	122,651	203,636	253,428	658,215	
Percent of total	11.9%	18.6%	31.0%	38.5%	100.0%	

The maturity profile of investments at 31 December 2011 was as follows:

	Within 1 year $	2 to 3 years $	4 to 5 years $	Over 5 years $	Total $	Effective interest rate ranges
Bonds	30,696	110,411	172,660	195,039	508,806	0.60%-10.25%
Mortgages	7,805	3,556	8,067	69,260	88,688	2.75%-9.00%
Policyholder loans	206	412	412	3,092	4,122	4.75%-8.25%
Corporate loans	3,487	-	1,054	-	4,541	1.90%-5.25%
	42,194	114,379	182,193	267,391	606,157	
Percent of total	7.0%	18.9%	30.0%	44.1%	100.0%	

(in thousands of Bermuda dollars except share and per share amounts)

The maturity profiles of the Group's significant insurance and financial liabilities are summarized in the following tables. Maturity profiles for financial liabilities are disclosed according to contractual maturity dates. Maturity profiles for insurance liabilities are based on expectations.

The maturity profile of liabilities at 31 December 2012 is as follows:

	Within 1 year $	1-5 years $	Over 5 years $	Total $
Insurance contract liabilities	134,278	47,704	195,663	377,645
Investment contract liabilities	81,077	236,235	605	317,917
Other liabilities	64,712	585	-	65,297
Loans payable	7,716	18,141	-	25,857
Total	**287,783**	**302,665**	**196,268**	**786,716**

The maturity profile of liabilities at 31 December 2011 was as follows:

	Within 1 year $	1-5 years $	Over 5 years $	Total $
Insurance contract liabilities	86,678	57,057	166,887	310,622
Investment contract liabilities	72,401	216,880	296	289,577
Other liabilities	42,765	-	-	42,765
Loans payable	645	3,070	-	3,715
Total	**202,489**	**277,007**	**167,183**	**646,679**

iii) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate as a result of changes in market factors. Market risk comprises three types of risk: foreign exchange rates (currency risk), market interest rates (interest rate risk) and market prices (price risk).

Currency risk

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Group is not significantly exposed to foreign exchange risk because of the following:

- The majority of the Group's assets, liabilities, and earnings are denominated in Bermuda, Barbados or United States dollars;
- The Bermuda and United States dollar are at par;
- The exchange rate between Bermudian and Barbadian dollars has remained unchanged since the acquisition of the Barbadian entity;
- Contracts written in the Cayman Islands are denominated in United States dollars;
- Contracts written in the Bahamas are denominated in United States or Bahamian dollars which are at par; and
- The Group's Canadian operation is fully integrated. Its assets and liabilities are not considered material.

Interest rate risk
Interest rate risk is price volatility produced by changes in the overall level of interest rates. Change in market interest rates can impact the reinvestment of matured investments, as the returns available on the new investment may be significantly different from the returns previously achieved. The Group manages these risks through:

- Asset allocation and diversification of the investment portfolio;
- Utilization of a formal process for managing the matching of assets and liabilities;
- Investing in assets that are suitable for the products sold;
- Investing in fixed income assets that closely match the life liability product cash flows for products with fixed and highly predictable benefit payments; and
- Quantifying and reviewing regularly the risk associated with the mismatch in portfolio duration and cash flow.

The sensitivity analysis for interest rate risk illustrates how changes in the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates at the reporting date.

Investment contracts with fixed and guaranteed terms held to maturity are accounted for at amortized cost and their carrying amounts are not sensitive to changes in the level of interest rates.

In relation to financial assets, management monitors the sensitivity of reported interest rate movements by assessing the expected changes in the different portfolios due to parallel movements of 100 basis points in all yield curves.

The impact of interest rate risk for the Group's actuarial liabilities and the assets supporting those liabilities is included in Note 4 B - Insurance Risk below. The Group also holds fixed income investments which support non-life insurance liabilities and surplus. If interest yields on the fixed income assets supporting non-life insurance liabilities and surplus had been 100 basis points higher/lower, profit would have been $1,703 (2011 - $1,260) higher/lower. The interest rate sensitivity impact was calculated using the modified duration method.

Price risk
Price risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting the market.

The Group's price risk exposure relates to financial assets and financial liabilities whose values will fluctuate as a result of changes in market prices, principally investment securities.

The Group's price risk policy requires it to manage such risks by setting and monitoring objectives and constraints on investments, diversification plans, limits on investments in each country, sector and market.

A 5% increase/decrease in the value of the Group's equity portfolio would increase/decrease the Group's comprehensive income by $342 (2011 - $451) and the Group's other components of equity by $231 (2011 - $354). The price risk sensitivity impact was calculated by using the ending balances in equity at a 5% increase/decrease.

B. INSURANCE RISK

i) Life and health insurance risk
Insurance risk in the Group arises through its exposure to mortality and morbidity risks and exposure to worse than anticipated operating experience on factors such as persistency levels and management and administration expenses.

Management of life and health insurance risks
The Group has developed an insurance risk policy and guidelines on the practical application of this policy. Individual insurance risks are managed at a business unit level but are also monitored at Group level.

The impact of insurance risk is monitored by the business units as part of the control cycle of business management. Exposure is monitored through the assessment of liabilities and the asset liability management framework process. At the Group level the overall exposure to insurance risk is measured through management reporting and Dynamic Capital Adequacy Test ("DCAT") and Minimum Continuing Capital and Surplus Requirement ("MCCSR") analysis.

The Risk Committee monitors the application of the risk policy in each business, and receives management information on life and health insurance risks. The committee considers all areas of insurance risk, but in particular has a remit to monitor mortality, longevity, morbidity, persistency, product design and pricing.

The Board of Directors considers the reinsurance coverage across the life and health businesses. It confirms that guidance and procedures are in place for each of the major components of life insurance risk, and that the businesses mitigate against any insurance risk within the parameters for the overall Group risk appetite.

The Board of Directors has also developed guidance for business units on management of a number of areas of insurance risk to ensure best practice is shared throughout the Group and common standards are adopted.

The individual life and health insurance risks are managed as follows:

- Mortality and morbidity risks are mitigated by use of reinsurance. The Group companies select reinsurers, from those approved by the Group, based on local factors, but assess the overall program to manage Group-wide risk exposures and monitor that the aggregation of risk ceded to individual reinsurers is within appetite for credit risk.

- Longevity risk: Whilst individual Group companies are responsible for reserving and pricing for annuity business, the Group monitors the exposure to this risk and the capital implications to manage the impact on the Group-wide exposure and the capital funding that Group companies may require as a consequence. The Group has used reinsurance solutions to reduce the risks from longevity where possible and desirable.

- Persistency risk: Where possible the financial impact of lapses is reduced through appropriate product design. Group companies also implement specific initiatives to improve retention of policies which may otherwise lapse.

- Product design and pricing risk arises from poorly designed or inadequately priced products and can lead to both financial loss for and reputational damage to the Group. Guidelines have been developed to support the Group companies through the complete cycle of the product development process, financial analysis and pricing.

- Expense risk is primarily managed by the Group companies through the assessment of profitability and frequent monitoring of expense levels.

Sensitivity testing is widely used to measure the capital required and volatility in earnings due to exposure to life and health insurance risks. This assessment is taken at both business unit level and at Group level where the impact of aggregation of similar risks can be measured. This enables the Group to determine whether action is required to reduce risk, or whether that risk is within the overall risk appetite.

(in thousands of Bermuda dollars except share and per share amounts)

Concentration risk
The following table shows life and health insurance liabilities by geographic area.

	2012			2011		
	Gross	Ceded	Net	Gross	Ceded	Net
Bermuda	160,190	(5,385)	154,805	148,235	90	148,325
Bahamas	1,502	14	1,516	915	(5)	910
Barbados	6,128	(4)	6,124	2,237	-	2,237
Other Caribbean & Latin America	1,237	6,020	7,257	6,054	-	6,054
Other*	44,124	10,140	54,264	32,383	8,369	40,752
	213,181	10,785	223,966	189,824	8,454	198,278

*Other includes Europe, Asia, the Middle East and the Americas, but no one area is significant within the total.

Sensitivity test analysis
The Group uses a number of sensitivity test-based risk management tools to understand the volatility of earnings, the volatility of its capital requirements, and to manage its capital more efficiently. Sensitivities to economic and operating experience are regularly produced on all of the Group's financial performance measurements to inform the Group's decision making and planning processes, and as part of the framework for identifying and quantifying the risks to which each of its business units, and the Group as a whole, are exposed.

The following provides information about the Group's life and health insurance contract liabilities sensitivities to management's best estimate of the approximate impact as a result of changes in assumptions used to determine the Group's liability associated with these contracts.

Mortality
Mortality refers to the rates at which death occurs for defined groups of people. For life products where higher mortality would be financially adverse to the Group, a 1% increase in the best estimate assumption would increase the actuarial liabilities by $165 (2011 -$130). For annuity products where lower mortality would be financially adverse to the Group, a 1% decrease in the best estimate assumption would increase the actuarial liabilities by $245 (2011 -$221).

Morbidity
Morbidity refers to both the rates of accident or sickness and the rates of recovery there from. The Group's long term disability and medical expense insurance is marketed mostly on a group basis. The most significant morbidity risk relates to the individual and group health business. A 1% increase in medical claims net of reinsurance would increase the actuarial liabilities by $860 (2011 -$900).

Investment returns
Assets are notionally segmented to correspond to the different liability categories of the Group. For each segment, the projected current asset and liability cash flows are used in the Canadian Asset Liability Method ("CALM") under several interest rate scenarios to determine the actuarial liabilities. Asset cash flows are reduced to provide for asset default losses.

Interest rate risk associated with this assumption is measured by determining the effect on the present value of the projected net asset and liability cash flows of the Group of an immediate 1% increase or an immediate 1% decrease in the level of interest rates. These interest rate changes will impact the projected cash flows.

The effect of an immediate 1% increase in interest rates would be to decrease the present value of these net projected cash flows by approximately $143 (2011 -$4,670). The effect of an immediate 1% decrease in interest rates would be to increase the present value of these net projected cash flows by approximately $258 (2011 -$4,633).

The level of actuarial liabilities established under the CALM valuation provides for interest rate movements other than the 1% movements indicated above.

Expenses
Actuarial liabilities provide for future policy-related expenses. These include the costs of premium collection, claims adjudication and processing, related consulting services, preparation and mailing of policy statements and related indirect expenses and overheads. Expense risk is the risk that future expenses are higher than assumed. A unit expense study is performed annually to determine an appropriate estimate of future expenses by liability type. An inflation assumption is incorporated in the estimate of future expenses consistent with the interest rate scenarios projected under CALM. A 10% increase in the best estimate maintenance unit expense assumption would increase the actuarial liabilities by approximately $1,665 (2011 -$1,440).

Persistency
Policyholders may allow their policies to terminate prior to the end of the contractual period by choosing not to continue to pay premiums or by exercising one of the non-forfeiture options contained in the contract. Assumptions for termination experience on life insurance are based on industry and the Group's experience. Termination rates vary by plan, policy duration and method of premium payment. For universal life policies, it is also necessary to set assumptions about premium cessation occurring prior to termination of the policy. A 10% adverse change in the best estimate policy termination assumption would increase the actuarial liabilities by $1,269 (2011 -$1,051).

Policyholder dividends
Future policyholder dividends are included in the determination of actuarial liabilities for participating policies, with the assumption that future policyholder dividends will change to reflect the experience of the respective participating accounts consistent with the participating policyholder dividend policies. Changes in the best estimate assumptions for the participating business would, in our expectation, correspond to changes in policyholder dividend scales that would not result in a material net change in actuarial liabilities for participating business.

ii) General insurance risk
The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. Insurance risk is implicit in the Group's insurance business and arises as a consequence of the type and volume of business written and the concentration of risk in particular policies or groups of policies subject to the same risks.

Types of risk
General insurance risk in the Group arises from:

- Fluctuations in the timing, frequency and severity of claims and claim settlements relative to expectations;
- Unexpected claims arising from a single source;
- Inaccurate pricing of risks or inappropriate underwriting of risks when underwritten;
- Inadequate reinsurance protection or other risk transfer techniques; and
- Inadequate reserves.

The majority of the general insurance business underwritten by the Group is of a short term nature such as property, motor and marine insurances. The Group's underwriting strategy and appetite is agreed by the Board of Directors and communicated via specific policy statements and guidelines. Like the life insurance risk, general insurance risk is managed primarily at business unit level with oversight at a Group level.

Management of general insurance risks
The Group's insurance risk policy sets out the overall framework for the management of insurance risk. As part of the framework, a structure of delegated pricing and underwriting authorities is in place. Pricing is based on assumptions which consider past experience and trends. Insurance exposures are limited through reinsurance. Overall, the Group seeks to be conservative in its acceptance of insurance risks by establishing strict underwriting criteria and limits. The underwriting policy is clearly documented, setting out risks which are unacceptable and the terms applicable for non-standard risks.

Significant insurance risks will be reported through the risk management framework. The estimated cost of claims includes direct expenses to be incurred in settling claims, net of the expected subrogation value and other recoveries. The Group takes all reasonable steps to ensure that it has appropriate information regarding its claims exposures. However, given the uncertainty in establishing claims provisions, it is likely that the final outcome will prove to be different from the original liability established. The liability for these contracts comprises a provision for IBNR, a provision for reported claims not yet paid and a provision for unexpired risks at the end of the reporting period.

Management under the direction of the Board of Directors monitors and develops the management of insurance risk in the general insurance business units, and assesses the aggregate risk exposure. It is responsible for the development, implementation and review of the Group policies for underwriting, claims, reinsurance and reserving that operate within the risk management framework.

BF&M General, ICBL, and IHHL have developed mechanisms that identify, quantify and manage accumulated exposures to contain them within the limits of the appetite of the Group. Where appropriate such mechanisms are employed throughout the business units to promote the adoption of best practice as standard.

Reinsurance strategy
Reinsurance is used to reduce potential loss to the Group from individual large risks and catastrophic events. It may also be used to manage capital or to provide access to specialist underwriting expertise.

Significant reinsurance programs are reviewed annually at both business unit and Group level, to verify that the levels of protection being purchased reflect any developments in exposure and the risk appetite of the Group. The reinsurance arrangements include surplus share, quota share and excess of loss catastrophe treaties. In addition to the overall Group reinsurance program, individual business units are permitted to purchase additional reinsurance protection.

Reinsurance purchases are in line with the strategy set out in our Reinsurance policy. The basis of these purchases is underpinned by extensive financial and capital modeling and actuarial analysis to optimize the cost and capital efficiency benefits from our reinsurance program.

The reinsurance is placed with providers who meet the Group's counterparty security requirements, and large reinsurance placements may also require approval from the Board of Directors.

(in thousands of Bermuda dollars except share and per share amounts)

Concentration risk

Processes are in place to manage catastrophe risk in individual business units and at a Group level. The Group cedes much of its catastrophe risk to third-party reinsurers but retains a pooled element for its own account gaining diversification benefit.

The concentration of insurance risk before and after reinsurance by territory in relation to the type of general insurance business risk accepted is summarized below, with reference to the carrying amount of the insurance reserve liabilities (gross and net of reinsurance) arising from general insurance contracts:

31 December 2012

Territory		Property $	Motor $	All Other $	Total $
Bermuda					
	Gross	6,661	3,589	4,400	14,650
	Net	984	2,461	2,083	5,528
Cayman/Other Caribbean					
	Gross	4,434	1,122	974	6,530
	Net	1,238	779	90	2,107
Barbados					
	Gross	3,124	44,800	7,492	55,416
	Net	245	30,803	5,691	36,739
Total					
	Gross	14,219	49,511	12,866	76,596
	Net	2,467	34,043	7,864	44,374

31 December 2011

Territory		Property $	Motor $	All Other $	Total $
Bermuda					
	Gross	10,700	3,266	2,488	16,454
	Net	859	2,315	1,566	4,740
Barbados					
	Gross	2,987	46,842	11,226	61,055
	Net	310	33,502	8,757	42,569
Total					
	Gross	13,687	50,108	13,714	77,509
	Net	1,169	35,817	10,323	47,309

General insurance business claims reserving

The subsidiaries writing general insurance business have a documented reserving policy setting out the basis on which liabilities are to be determined using statistical analysis and actuarial experience. Policies for each subsidiary are in line with relevant local regulation and legislation.

Management monitors and conducts quarterly reviews of the Group's general insurance claims provisions, and their adequacy.

The Group has claims departments dealing with the mitigation of risks surrounding known exposures. These departments investigate and adjust a majority of the claims. The claims are reviewed individually on a quarterly basis and adjusted to reflect the latest information on the underlying facts, current law, jurisdiction, contractual terms and conditions, and other factors. The Group actively manages and pursues early settlements of claims to reduce its exposure to unpredictable developments.

The adequacy of the Group's general insurance claims provisions is ultimately overseen by the Board of Directors.

The estimation of the claims incurred but not reported reserve ("IBNR") is generally subject to a greater degree of uncertainty than the estimation of the cost of settling claims already notified to the Group, where information about the claim event is available. IBNR claims may not be apparent to the insured until many years after the event that gave rise to the claims. For casualty contracts, the IBNR liability will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty of estimating these liabilities.

In estimating the liability for the cost of reported claims not yet paid, the Group considers any information available from loss adjusters and information on the cost of settling claims with similar characteristics in previous periods. Large claims are assessed on a case-by-case basis in order to allow for the possible distortive effect of their development and incidence on the rest of the portfolio.

Claims development tables

The development of insurance liabilities provides a measure of the Group's ability to estimate the ultimate value of claims. The top half of each table illustrates how the Group's estimate of total claims outstanding for each accident or underwriting year has changed at successive year-ends. The bottom half of the table reconciles the cumulative claims to the amount appearing in the consolidated statement of financial position. A calendar year basis is considered to be most appropriate for the business written by the Group.

(in thousands of Bermuda dollars except share and per share amounts)

Bermuda
Gross loss development:

Underwriting year Estimate of ultimate claims cost:	2007 $	2008 $	2009 $	2010 $	2011 $	2012 $	Total $
At the end of the valuation year*	6,494	10,067	8,413	9,760	17,992	5,746	-
One year later	6,483	9,680	8,409	9,825	18,403	-	-
Two years later	6,197	9,654	9,142	9,583	-	-	-
Three years later	6,156	9,924	9,158	-	-	-	-
Four years later	6,133	9,811	-	-	-	-	-
Five years later	6,118	-	-	-	-	-	-
Current estimates of cumulative claims	6,118	9,811	9,158	9,583	18,403	5,746	58,819
Cumulative payments to date	(6,029)	(9,064)	(8,774)	(9,184)	(10,285)	(1,930)	(45,266)
Liability recognized in the consolidated statement of financial position	89	747	384	399	8,118	3,816	13,553
Reserve in respect of prior years							1,118
Total reserve included in the consolidated statement of financial position							**14,671**

Net loss development:

Underwriting year Estimate of ultimate claims cost:	2007 $	2008 $	2009 $	2010 $	2011 $	2012 $	Total $
At the end of the valuation year*	4,936	6,714	6,128	5,635	6,414	3,938	-
One year later	4,929	6,581	6,190	5,743	6,825	-	-
Two years later	4,758	6,376	6,789	5,478	-	-	-
Three years later	4,728	6,811	6,657	-	-	-	-
Four years later	4,703	6,651	-	-	-	-	-
Five years later	4,669	-	-	-	-	-	-
Current estimates of cumulative claims	4,669	6,651	6,657	5,478	6,825	3,938	34,218
Cumulative payments to date	(4,597)	(6,501)	(6,358)	(5,186)	(4,992)	(1,645)	(29,279)
Liability recognized in the consolidated statement of financial position	72	150	299	292	1,833	2,293	4,939
Reserve in respect of prior years							596
Total reserve included in the consolidated statement of financial position							**5,535**

*Estimates are presented on a completed underwriting year basis except for the current year which is on an uncompleted underwriting year basis.

(in thousands of Bermuda dollars except share and per share amounts)

Barbados and Cayman Islands
Gross loss development:

Accident year Estimate of ultimate claims cost:	2007 $	2008 $	2009 $	2010 $	2011 $	2012 $	Total $
At the end of accident year	30,988	44,928	23,353	26,877	34,614	30,172	-
One year later	31,822	42,667	22,666	24,934	32,074	-	-
Two years later	29,232	38,785	19,600	23,094	-	-	-
Three years later	27,541	38,169	20,929	-	-	-	-
Four years later	28,398	36,819	-	-	-	-	-
Five years later	27,716	-	-	-	-	-	-
Current estimates of cumulative claims	27,716	36,819	20,929	23,094	32,074	30,172	170,804
Cumulative payments to date	(18,208)	(34,145)	(15,674)	(17,554)	(24,759)	(14,333)	(124,673)
Liability recognized in the consolidated statement of financial position	9,508	2,674	5,255	5,540	7,315	15,839	46,131
Reserve in respect of prior years							15,794
Total reserve included in the consolidated statement of financial position							**61,925**

Net loss development:

Accident year Estimate of ultimate claims cost:	2007 $	2008 $	2009 $	2010 $	2011 $	2012 $	Total $
At the end of accident year	18,719	17,487	15,384	16,005	15,895	16,058	-
One year later	18,117	17,299	14,451	14,375	15,052	-	-
Two years later	16,216	14,409	13,357	13,522	-	-	-
Three years later	16,035	13,305	12,550	-	-	-	-
Four years later	16,286	12,582	-	-	-	-	-
Five years later	16,341	-	-	-	-	-	-
Current estimates of cumulative claims	16,341	12,582	12,550	13,522	15,052	16,058	86,105
Cumulative payments to date	(13,132)	(10,226)	(9,217)	(9,553)	(10,591)	(7,866)	(60,585)
Net liability recognized in the consolidated statement of financial position	3,209	2,356	3,333	3,969	4,461	8,192	25,520
Net reserve in respect of prior years							13,319
Total net reserve included in the consolidated statement of financial position							**38,839**

(in thousands of Bermuda dollars except share and per share amounts)

Total reserves included in the consolidated statement of financial position:

	Total $
Gross	
Bermuda	14,671
Barbados and Cayman Islands	61,925
Total*	**76,596**
Net	
Bermuda	5,535
Barbados and Cayman Islands	38,839
Total*	**44,374**

*Does not include unearned premium or claims payable of $82.

C. CAPITAL MANAGEMENT AND REGULATORY COMPLIANCE

The Group's policy is to maintain a strong consolidated capital base. The Group manages its capital to ensure its continued ability to provide an adequate return to shareholders, exceed insurance capital regulatory requirements, provide flexibility to take advantage of growth opportunities, maintain a strong credit rating, and to support the risks associated with the business of the Group. The Group's capital base consists of share capital, contributed surplus, share premium, accumulated other comprehensive loss, and retained earnings as disclosed on the consolidated statement of financial position.

Management monitors the adequacy of the Group and its operating subsidiaries' capital from the perspective of the Bermuda, Cayman and Barbados Insurance Acts and Companies Acts. The Group's practice is to maintain the capitalization of its regulated operating subsidiaries at a level that will exceed the relevant minimum regulatory capital requirements in the jurisdictions in which they operate. In addition, while not a regulatory requirement, BF&M Life and Bermuda International follow the capital adequacy measurement established by the Office of the Superintendent of Financial Institutions in Canada known as the Minimum Continuing Capital and Surplus Requirements ("MCCSR"). The Group's investment policies emphasize the preservation of capital and the maintenance of a diversified investment portfolio, which together serve to minimize the risk that investment activities pose to the Group's capital.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders or issue new shares.

(i) Bermuda

Under The Insurance Act 1978 (Bermuda), Amendments Thereto and Related Regulations (the "1978 Act"), the Group's Bermuda-based insurance subsidiaries are required to annually prepare and file statutory financial statements and a statutory financial return. The 1978 Act also requires the Group's insurance subsidiaries to meet minimum liquidity ratios and minimum capital and surplus requirements.

The 1978 Act limits the maximum amount of annual dividends and distributions that may be paid by the Group's insurance subsidiaries. Before reducing by 15% or more of its total statutory capital, as set out in the prior year's financial statements, these insurance companies shall request the approval of the Bermuda Monetary Authority ("BMA"). In addition, The Bermuda Companies Act 1981 (the "Companies Act") limits the Group's ability to pay dividends and distributions to shareholders if there are reasonable grounds for believing that the Group would be unable to pay its liabilities as they become due or if the realizable value of its assets would be less than the aggregate of its liabilities, issued share capital and share premium accounts.

During 2012 and 2011, the BMA issued several new legislative and regulatory initiatives, including Insurance Prudential Standards Rules and Group Supervision Rules, for insurance groups and insurance subsidiaries, which address solvency requirements and capital adequacy, as well as an Insurance Code of Conduct.

Subsidiaries holding a general insurance company license

Subsidiaries that hold a general insurance company license are required to monitor their capital adequacy using The Bermuda Solvency Capital Requirement – Small and Medium-sized Entities ("BSCR-SME") starting in 2011. Previously, commercial insurance companies holding a general license were required to maintain a minimum capital and surplus according to the greater of a minimum amount, a % of premium written and a % of loss and loss expense provisions. For all periods presented herein, the Group satisfied these requirements.

Subsidiaries holding a long term insurance company license

The Insurance Amendment (No. 3) Act 2010 (the "Amendment Act") came into force on 31 December 2010 creating new classes of long-term insurance licenses and establishing a capital adequacy monitoring regime for life insurance companies based on total assets. Previously, long-term insurance companies were required to maintain a minimum capital and surplus of $250. The applicable minimum margin of solvency for the financial year ending in 2012 shall be 75% of the greater of (a) $4,000 or 2% of the first $250 of assets plus 1.5% of assets above $250. For all periods presented herein, the Group's long term insurance subsidiaries satisfied these requirements.

(ii) Barbados

The Barbados Insurance (Catastrophe Reserve Fund) Regulations 2003-88 require the establishment of a catastrophe reserve fund. Annual amounts of up to 25% of net premium income from property insurance business are allocated to the fund. Assets representing the fund in the amount of $4,386 (2011 - $3,943) are placed in trust in accordance with the regulations of the Barbados Insurance Act.

Section 152 of the Barbados Insurance Act requires the appropriation towards a surplus reserve of at least 25% of net income until such time as the surplus reserve of the ICBL equals or exceeds the liability in respect of unearned premiums. A surplus reserve of $16,839 as at 2012 (2011 - $16,289) is included in ICBL's shareholders' equity in accordance with the requirements.

(iii) Cayman Islands

The Cayman Islands Monetary Authority ("CIMA") has statutory powers that enable it to use its discretion to require the Group to conduct its Cayman operations in accordance with general or specific conditions which may be imposed by CIMA or may be agreed between CIMA and the Group. A new Cayman Islands Insurance Law (the "new law") became effective November 2012; the Group has 18 months to comply with the requirements of the new law. Under this new law, the Group is required to maintain capital in excess of the greater of approximately $300 for domestic insurers or $1,000 for external insurers, and an amount determined as per a prescribed formula set out in legislation. The formula prescribes the minimum capital requirements for the Group's assets and liabilities based on the relative riskiness of the balances and also provides for a margin of catastrophe. The Group holds both a domestic insurer license and an external insurer Class A license. At 31 December 2012 and 2011, the Group was in compliance with its regulatory requirements.

(iv) Other jurisdictions:

Foreign operations in all other jurisdictions must comply with local capital and solvency requirements. For all periods presented herein, these operations satisfied these requirements.

5. SEGMENTAL INFORMATION

Management has determined the operating segments based on a combination of factors, including the products and geographical areas and on the basis of the reports reviewed by the Chief Executive Officer (CEO) of the Group that are used to make strategic decisions. All the operating segments used by management meet the definition of a reportable segment.

5.1. Health, life, annuity and pension (Bermuda)

This operating segment includes group and individual health and accident, life, disability, annuity and pension products.

5.2. Property and casualty (Bermuda)

This operating segment includes the following products: personal and commercial fire, windstorm, burglary, public liability, marine, special types, personal automobile, personal auto-cycle, workmen's compensation and commercial vehicles.

5.3 Real estate (Bermuda)

This operating segment includes the Group's real estate operations in Bermuda. The Group currently owns and occupies one building and is a majority owner in two buildings that are leased principally to non-related parties.

5.4 Barbados operations

This operating segment is identified by its geographical location. Insurance coverage includes motor, property, marine, miscellaneous accident, group health, group life, and pension business.

5.5 Cayman Islands and other Caribbean operations

This operating segment is identified by its geographical location. Insurance coverage includes motor, property, marine, and casualty business.

5.6 Corporate and other

Corporate operations consist of corporate level income and expenses and returns from investments not allocated to any operating segments. It also represents the combined operations of two holding companies, a management company, a financial reinsurance company, and an investment management company. The Group manages shared services centrally with most costs allocated based on either head count, expenses or revenues. Some central costs are not allocated and remain within the corporate group.

Measurement basis

The accounting policies of the segments are the same as those for the Group as a whole. The Group evaluates performance of operating segments on the basis of profit or loss from operations before tax.

Intersegment income is recorded at management's estimate of current market prices.

(in thousands of Bermuda dollars except share and per share amounts)

The segmental information provided to the CEO for the reportable segments for the year ended 31 December 2012 is as follows:

Segments	Health, life, annuity, and pension 2012	Property and casualty 2012	Real estate 2012	Barbados operations 2012	Cayman & Other Caribbean operations 2012	Corporate and other 2012	Total 2012
Income earned from external customers	129,666	31,601	3,030	37,206	29,286	239	231,028
Investment income	10,517	1,122	-	4,961	635	1	17,236
Total income	140,183	32,723	3,030	42,167	29,921	240	248,264
Amortization	1,744	1,144	843	1,445	304	1,591	7,071
Interest expense	-	-	156	-	-	577	733
Income tax expense	-	-	-	1,061	(738)	154	477
Shareholders' net income	7,223	9,418	1,523	3,486	3,627	(3,774)	21,503
Impairment losses recognized in income	5,012	-	-	281	-	-	5,293
Impairment losses recognized in other comprehensive income	-	-	-	180	-	-	180
Assets	1,062,996	68,939	26,859	200,192	128,973	38,581	1,526,540
Fixed asset & intangible expenditures	1,132	1,548	22	775	1,502	25,553	30,532
Liabilities	970,445	56,419	4,020	136,612	80,704	25,149	1,273,349

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
For the years ended 31 December 2012 and 2011
(in thousands of Bermuda dollars except share and per share amounts)

The segmental information provided to the CEO for the reportable segments for the year ended 31 December 2011 is as follows:

Segments	Health, life, annuity, and pension 2011 $	Property and casualty 2011 $	Real estate 2011 $	Barbados operations 2011 $	Corporate and other 2011 $	Total 2011 $
Income earned from external customers	126,637	29,513	3,030	34,835	1,470	195,485
Investment income	36,362	1,082	-	4,498	-	41,942
Total income	162,999	30,595	3,030	39,333	1,470	237,427
Amortization	2,705	1,074	827	1,467	110	6,183
Interest expense	-	-	180	-	-	180
Income tax expense	-	-	-	1,386	156	1,542
Shareholders' net income	15,521	13,601	1,883	2,691	(956)	32,740
Impairment losses recognized in income	482	-	-	-	-	482
Impairment losses recognized in other comprehensive income	-	-	-	211	-	211
Assets	977,590	103,376	27,169	193,191	15,886	1,317,212
Fixed asset & intangible expenditures	1,687	1,647	54	383	60	3,831
Liabilities	878,601	62,800	4,648	132,632	3,057	1,081,738

(in thousands of Bermuda dollars except share and per share amounts)

6. INVESTMENTS

A. CARRYING AMOUNT AND FAIR VALUE OF INVESTMENTS

Investments comprise:

	2012		2011	
	Carrying amount $	Fair value $	Carrying amount $	Fair value $
At fair value through profit and loss				
- Bonds*	447,336	447,336	397,406	397,406
- Equities*	23,910	23,910	22,272	22,272
- Derivatives*	883	883	850	850
Loans and receivables				
- Bonds	112,762	116,713	111,400	115,136
- Mortgages	90,286	90,194	88,688	88,599
- Policyholder loans	4,344	4,344	4,122	4,122
- Other loans	3,487	3,487	4,541	4,538
	683,008	**686,867**	**629,279**	**632,923**
Available for sale				
- Equities	4,613	4,613	7,082	7,082
- Residential properties	488	488	488	488
	5,101	**5,101**	**7,570**	**7,570**
Totals	**688,109**	**691,968**	**636,849**	**640,493**

*Included within certain investments are assets that back private placement insurance contracts. They are segregated and managed to meet the specific investment objectives of the policyholder. Liabilities relating to these contracts are included within insurance contract liabilities. The investment risk of these assets is borne by the customer. These assets comprise:

	2012		2011	
	Carrying amount $	Fair value $	Carrying amount $	Fair value $
Bonds	7,142	7,142	-	-
Equity / Mutual funds/Derivatives	17,687	17,687	13,558	13,558
	24,829	**24,829**	**13,558**	**13,558**

Included in the investments balance of $688,109 (2011 - $636,849) is $40,931 (2011 - $40,657) which has been pledged to meet the requirements of Section 25(5) of the Barbados Insurance Act 1996-32, $999 (2011 - $499) of financial assets which are being held by the Supervisor of Insurance of Barbados as required under Section 23(2)(b) of the Barbados Insurance Act and $1,118 (2011 - $0) of financial assets which are restricted by the Puerto Rico Commissioner of Insurance.

(in thousands of Bermuda dollars except share and per share amounts)

B. FAIR VALUE HIERARCHY

Fair value is the amount for which an asset could be exchanged or liability settled between knowledgeable willing parties in an arm's length transaction.

The Group classifies the fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The three levels of the fair value hierarchy are:

Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
Level 3 – Inputs that are not based on observable market data.

The following table illustrates the classification of the Group's investments measured at fair value as at 31 December 2012:

	Level 1 $	Level 2 $	Level 3 $	Total $
Financial assets at fair value through profit and loss				
Bonds	6,766	440,570	-	447,336
Equities	12,193	11,717	-	23,910
Derivatives	-	883	-	883
Available for sale financial assets				
Equities	3,859	754	-	4,613
Residential properties	-	488	-	488
	22,818	**454,412**	**-**	**477,230**

The following table illustrates the classification of the Group's investments measured at fair value as at 31 December 2011:

	Level 1 $	Level 2 $	Level 3 $	Total $
Financial assets at fair value through profit and loss				
Bonds	-	397,406	-	397,406
Equities	13,196	9,076	-	22,272
Derivatives	-	850	-	850
Available for sale financial assets				
Equities	6,377	705	-	7,082
Residential properties	-	488	-	488
	19,573	**408,525**	**-**	**428,098**

The Group does not hold any Level 3 financial assets. During the year there were no transfers between Levels 1 and 2.

(in thousands of Bermuda dollars except share and per share amounts)

C. INVESTMENT INCOME

	2012 $	2011 $
Investment income		
Bonds at FVTPL – interest income	10,488	11,551
Bonds at amortized cost – interest income	6,963	6,406
Equities at FVTPL – dividend income	311	410
Equities at available for sale – dividend income	160	159
Mortgages and loans – loans and receivables – interest income	5,466	5,554
Bank deposits and policyholder loans	689	814
Net realized gains on available for sale assets	1,085	-
Change in fair value of financial assets at fair value through profit and loss		
Bonds	4,835	25,742
Equity	290	(90)
Less: Impairment provision on mortgages and loans	(5,012)	(482)
Less: Impairment loss on available for sale assets	(281)	-
Less: Allocation to contracts for the account and risk of customers	(7,758)	(8,121)
Total	**17,236**	**41,943**

7. SEGREGATED FUNDS

(i) Segregated funds – consolidated net assets

	2012 $	2011 $
Mutual funds	478,911	414,838
Cash and short term deposits	-	10,048
Total segregated funds assets	**478,911**	**424,886**

(in thousands of Bermuda dollars except share and per share amounts)

(ii) Segregated funds – consolidated statements of changes in net assets

	2012 $	2011 $
Segregated funds assets – beginning of year	424,886	453,639
Additions:		
Pension contributions	69,128	65,523
Life insurance	17	55
Net realized and unrealized gains (losses)	50,596	(20,179)
Other investment income	6	108
Total additions	119,747	45,507
Deductions		
Payments to policyholders and their beneficiaries	(60,250)	(69,088)
Management fees	(5,143)	(5,066)
Losses paid	(262)	(86)
Underwriting expenses	(67)	(20)
Total deductions	(65,722)	(74,260)
Net additions to segregated funds	54,025	(28,753)
Segregated funds assets – end of year	**478,911**	**424,886**

8. CASH AND CASH EQUIVALENTS

	2012 $	2011 $
Cash at bank and in hand	64,735	49,751
Short-term bank deposits	23,135	25,668
Total	**87,870**	**75,419**

As at 31 December 2012, $13,884 (2011 - $1,212) was classified as restricted cash as the balance was required to be held in trust per statutory requirements of certain jurisdictions in which the Group operates.

9. INSURANCE RECEIVABLES AND OTHER ASSETS

	2012 $	2011 $
Insurance receivables	48,190	24,223
Accounts receivable	28,254	24,581
Investment income due and accrued	5,424	5,222
Total	**81,868**	**54,026**

(in thousands of Bermuda dollars except share and per share amounts)

10. DEFERRED POLICY ACQUISITION COSTS

A reconciliation of the change in deferred policy acquisition costs is shown below:

	2012 $	2011 $
At 1 January	2,110	1,968
Value of business acquired	7,949	-
Recognized deferred acquisition costs	21,719	4,078
Amortization charge through income	(21,623)	(3,936)
At 31 December	**10,155**	**2,110**

11. INVESTMENT CONTRACT LIABILITIES

Investment contracts are those that do not transfer significant insurance risk from the contract holder to the issuer, and are therefore treated as financial instruments under IFRS. The composition of investment contract liabilities and the movement in liabilities are shown below:

	2012 $	2011 $
Guaranteed interest pension		
Bermuda	263,678	243,451
Barbados	50,329	42,598
Term certain annuities	3,910	3,528
Total investment contract liabilities	**317,917**	**289,577**

	2012 $	2011 $
At 1 January	289,577	245,210
Pension contributions	54,868	50,337
Interest credited	7,609	16,877
Benefits paid	(40,799)	(37,439)
Management fees deducted	(286)	(252)
Net transfers in	6,948	14,844
At 31 December	**317,917**	**289,577**

The fair value hierarchy level of investment contract liabilities is reported below. Refer to note 6B – Fair Value Hierarchy for a description of the hierarchy classification levels. These investments are not quoted in an active market and their fair values are determined using valuation techniques. A variety of factors are considered in the Group's valuation techniques, such as yield curve, credit spreads and default assumptions, which have market observable inputs. These investment contract liabilities are classified as Level 2 instruments in the fair value hierarchy.

	Level 1 $	Level 2 $	Level 3 $	Total $
Fair value by hierarchy level as at:				
31 December 2012	-	317,917	-	317,917
31 December 2011	-	289,577	-	289,577

12. INSURANCE CONTRACT LIABILITIES

A. ASSUMPTIONS AND METHODOLOGY

(i) Life and health insurance contracts

The nature of life and health insurance business is such that a number of assumptions are made in compiling these consolidated financial statements. Assumptions are made about investment returns, mortality rates, lapse rate, morbidity, expenses and premium payment patterns in connection with the in-force policies for each business unit. Assumptions are best estimates based on historic and expected experience of the business.

The valuation of liabilities was performed using the CALM. In some instances approximations are used due to the nature of liabilities. The approximations are not expected to change the results materially. Best estimate assumptions were generally based on industry and company experience. Provisions for adverse deviations ("PfADs") were determined by applying appropriate margins for adverse deviations ("MfADs") to the best estimate assumptions.

Investment Returns

With the exception of assets backing certain participating liabilities, assets are not formally segmented by line of business or product line. Invested assets are notionally segmented to support the actuarial liabilities valued under CALM. For each segment the future cash flows from insurance and investment contracts and the assets supporting them are projected under a number of interest rate scenarios some of which are prescribed for CALM under Canadian Actuarial Standards of Practice or an approximation of CALM. Future reinvestments in investment grade bonds and mortgages are assumed to earn a credit spread above the risk-free Treasury yield based on current and future expected market conditions. U.S. Treasury and Agency bonds were assigned no risk default charge. Other asset defaults were based on industry experience.

Mortality

Mortality refers to the rates at which death is expected to occur for defined classes of insured. The Group's portfolio of business is too small to form the basis for any internally produced mortality assumption. The Group's mortality assumption is based on industry experience. The assumed mortality rates for life insurance contracts do not reflect any future improvement. For life contingent annuities, the assumed mortality assumption includes future mortality improvement, the effect of which is to increase insurance contract liabilities, based on prescribed mortality improvement rates promulgated by the ASB.

Lapse

The best estimate lapse assumption is based on a combination of industry and the Group's lapse experience and pricing assumptions for newer products.

Expenses

Actuarial liabilities provide for future administrative policy-related expenses. These include the costs of premium collection, claims adjudication and processing, relating consulting services, preparation and mailing of policy statements and related indirect expenses and overheads. A unit expense study is performed annually to determine an appropriate estimate of future expenses by liability type. An inflation assumption is incorporated in the estimate of future expenses consistent with the interest rate scenarios projected under CALM.

Premium payment patterns

Universal life liabilities are sensitive to the amount of discretionary premium received from the policyholders. A premium persistency assumption is made for all universal life products and can vary by plan, age and policy duration.

(in thousands of Bermuda dollars except share and per share amounts)

(ii) Short-term insurance contract liabilities

The ultimate cost of outstanding contract liabilities are estimated by using a range of standard actuarial claims projections techniques, such as the Incurred Development Methodology and the Bornhuetter-Ferguson methods. The main assumption underlying these techniques is that the Group's past claims development experience can be used to project future claims development and hence ultimate claims costs. Historical claims development is analysed by either accident period or underwriting period. Claims development is analysed for each geographical area as well as by line of business.

B. COMPOSITION OF INSURANCE CONTRACT LIABILITIES

	2012 $	2011 $
Gross		
Short term insurance contracts:		
Claims reported and loss adjustment expenses	62,378	60,859
Unearned premiums	87,868	43,289
Claims incurred but not reported	14,218	16,650
Total short-term insurance contracts	164,464	120,798
Life and health insurance contracts:		
Participating		
Individual life	30,409	30,930
Non-participating		
Individual life	66,030	52,201
Individual and group annuities	83,129	74,163
Group life	11,932	10,229
Health and accident	21,681	22,301
Total life and health insurance contracts	213,181	189,824
Total insurance contract liabilities - gross	**377,645**	**310,622**
Net		
Short term insurance contracts:		
Claims reported and loss adjustment expenses	35,849	34,971
Unearned premiums	35,888	22,183
Claims incurred but not reported	8,525	12,337
Total short term insurance contracts	80,262	69,491
Life and health insurance contracts:		
Participating		
Individual life	31,484	31,851
Non-participating		
Individual life	77,507	61,473
Individual and group annuities	83,129	74,163
Group life	10,208	8,489
Health and accident	21,638	22,302
Total life and health insurance contracts	223,966	198,278
Total insurance contract liabilities - net	**304,228**	**267,769**

(in thousands of Bermuda dollars except share and per share amounts)

C. CHANGES IN SHORT TERM INSURANCE CONTRACT LIABILITIES

	2012			2011		
	Gross $	Reinsurers' Share $	Net $	Gross $	Reinsurers' Share $	Net $
At 1 January						
Claims and adjustment expenses	60,859	(25,888)	34,971	51,467	(16,617)	34,850
Claims incurred but not reported	16,650	(4,312)	12,338	16,347	(2,783)	13,564
Total at 1 January	77,509	(30,200)	47,309	67,814	(19,400)	48,414
Liabilities acquired during acquisition	5,974	(4,375)	1,599			
Cash paid for claims settled in year	(34,864)	12,115	(22,749)	(23,230)	6,418	(16,812)
Increase in liabilities:						
Arising from current-year claims	24,196	(7,358)	16,838	29,394	(13,522)	15,872
Arising from prior-year claims	3,781	(2,404)	1,377	3,531	(3,696)	(165)
Total at 31 December	**76,596**	**(32,222)**	**44,374**	**77,509**	**(30,200)**	**47,309**
Claims and adjustment expenses	62,378	(26,529)	35,849	60,859	(25,888)	34,971
Claims incurred but not reported	14,218	(5,693)	8,525	16,650	(4,312)	12,338
Total at 31 December	**76,596**	**(32,222)**	**44,374**	**77,509**	**(30,200)**	**47,309**

The fair value of the net provision for claims and adjustment expenses of $44,374 (2011 - $47,309) is $39,762 (2011 - $40,388). The fair value is calculated by the Group's actuaries and represents the discounted value of the net provision.

(in thousands of Bermuda dollars except share and per share amounts)

D. UNEARNED PREMIUM LIABILITY

	2012			2011		
	Gross $	Reinsurance $	Net $	Gross $	Reinsurance $	Net $
At 1 January	**43,289**	**(21,106)**	**22,183**	**41,026**	**(18,859)**	**22,167**
Acquired during business combinations	42,918	(26,346)	16,572	-	-	-
Premium written during the year	190,907	(135,603)	55,304	105,311	(58,014)	47,297
Premium earned during the year	(189,246)	131,075	(58,171)	(103,048)	55,767	(47,281)
Total at 31 December	**87,868**	**(51,980)**	**35,888**	**43,289**	**(21,106)**	**22,183**
Movement during the year, net of acquisition	**(1,661)**	**4,528**	**2,867**	**(2,263)**	**2,247**	**(16)**

E. CHANGES IN LIFE AND HEALTH INSURANCE CONTRACT LIABILITIES

	2012			2011		
	Gross	Ceded	Net	Gross	Ceded	Net
Provision for policy benefits	184,409	8,454	192,863	152,443	5,515	157,958
Claims payable	4,894	-	4,894	6,949	-	6,949
Provision for participating policyholders	521	-	521	62	-	62
Life and health insurance contract liabilities - 1 January	**189,824**	**8,454**	**198,278**	**159,454**	**5,515**	**164,969**
Change in provision for policy benefits:						
Aging and changes in balances on in-force policies	21,942	3,998	25,940	24,100	(71)	24,029
Changes in assumptions:						
Investment returns	2,496	3	2,499	5,642	2,009	7,651
Mortality	(1,015)	(72)	(1,087)	149	1,055	1,204
Lapse	618	44	662	-	-	-
Expense	432	25	457	527	(48)	479
Premium payment patterns	608	43	651	373	(26)	347
Other	(1,286)	(100)	(1,386)	(164)	20	(144)
Other changes	1,122	(1,610)	(488)	1,339	-	1,339
	24,917	2,331	27,248	31,966	2,939	34,905
Provision for policy benefits	209,326	10,785	220,111	184,409	8,454	192,863
Claims payable	3,881	-	3,881	4,894	-	4,894
Provision for participating policyholders	(26)	-	(26)	521	-	521
Life and health insurance contract liabilities – 31 December	**213,181**	**10,785**	**223,966**	**189,824**	**8,454**	**198,278**

(in thousands of Bermuda dollars except share and per share amounts)

The majority of the fair value of future policy benefits is determined by reference to the fair value of the assets supporting those liabilities. As assets supporting future policy benefits are reported at fair value on the balance sheet, the change in the value of those assets would be largely offset by a change in the value of liabilities, where the duration of the assets and liabilities are closely matched, resulting in limited changes to surplus.

F. COMPOSITION OF THE ASSETS SUPPORTING LIABILITIES

The composition of the assets supporting life and health insurance contract liabilities is as follows:

	2012					
	Bonds $	Mortgages and loans $	Equities $	Derivatives $	Cash $	Total $
Participating						
Individual life	27,371	3,207	-	-	906	31,484
Non-participating						
Individual life	47,102	11,919	17,077	883	526	77, 507
Individual and group annuities	55,954	27,175	-	-	-	83,129
Group life	1,919	3,154	-	-	5,135	10,208
Health and accident	-	604	-	-	21,034	21,638
	132,346	**46,059**	**17,077**	**883**	**27,601**	**223,966**

	2011					
	Bonds $	Mortgages and loans $	Equities $	Derivatives $	Cash $	Total $
Participating						
Individual life	20,725	8,869	-	-	2,257	31,851
Non-participating						
Individual life	33,159	11,490	13,250	850	2,724	61,473
Individual and group annuities	49,903	20,627	-	-	3,634	74,164
Group life	6,350	-	-	-	2,138	8,488
Health and accident	13,950	-	-	-	8,352	22,302
	124,087	**40,986**	**13,250**	**850**	**19,105**	**198,278**

(in thousands of Bermuda dollars except share and per share amounts)

13. REINSURANCE ASSETS

Reinsurance assets are comprised of the following:

	2012 $	2011 $
Short-term insurance contracts:		
Claims reported and adjustment expenses	26,529	25,888
Unearned premiums ceded	51,980	21,106
Claims incurred but not reported	5,693	4,312
Total short-term insurance contracts	84,202	51,306
Life and health insurance contracts:		
Participating		
Individual life	(1,075)	(921)
Non-participating		
Individual life	(11,477)	(9,272)
Individual and group annuities	-	-
Group life	1,724	1,740
Health and accident	43	-
Total life and health insurance contracts	(10,785)	(8,453)
Total reinsurance assets	**73,417**	**42,853**

14. RETIREMENT BENEFIT OBLIGATIONS

A. DEFINED CONTRIBUTION PENSION PLAN

The Group sponsors a defined contribution pension plan for Bermuda employees who were hired after 1 January 1999 and for those who elected to convert from the defined benefit plan as of 1 January 1999. The cost of the defined contribution pension plan is not reflected in the tables below. Contributions of $1,183 (2011 - $1,100) equating to the service cost for the year for these employees were made to this plan. The employer portion was $588 (2011 - $547).

In 2007, ICBL introduced a defined contribution plan for new employees. Contributions of $109 (2011 - $72) equating to the service cost for the year for these employees were made to this plan.

IHHL participates in a defined contribution pension scheme as required under Cayman Island law. During the 9 months ending December 31, 2012, IHHL contributed $137.

B. POST RETIREMENT MEDICAL PLAN AND IMPACT OF CURTAILMENT

The Group also sponsors a post-retirement medical benefit plan for its Bermuda employees. The main benefit provided is for health care. Prior to 1 January 2012, the Group paid 50% of the total premiums paid to the insurer and the pensioner paid the balance. Retirees after 31 December 2011 pay 100% of their premiums if they want to continue to be covered by the plan. This change reduced the number of current employees who will be prospectively entitled to benefits. This was treated as a curtailment in the following disclosures. The resulting change of $9,629 is reported as a gain in the 2011 consolidated statement of income.

The Group also offers medical insurance benefits to retired employees in Barbados. Sixty percent (60%) of the premium is funded by ICBL. The present value of this future benefit obligation is calculated by a qualified actuary and the amount is accrued at the end of each year.

Total contributions to the plans by the Group in 2012 were $301 (2011 - $294).

(in thousands of Bermuda dollars except share and per share amounts)

C. DEFINED BENEFIT PENSION PLAN

The Group sponsors a defined benefit pension plan for eligible employees. The pension amount at retirement is based on an employee's final average earnings. The scheme is generally funded through payments determined by periodic actuarial calculations. Cash contributions to the plan by the Group during 2012 was $3,692 (2011 - $3,692).

i) Benefit obligation, plan assets and funded status

The Group measures the fair value of assets and the accrued benefit obligations as of 31 December. The most recent actuarial valuation of the pension plan for funding and accounting purposes was as of 31 December 2012.

The following table provides summaries of the defined benefit pension and post-retirement medical plans' estimated financial position at 31 December 2012 and 2011:

	Defined benefit pension plans		Medical benefit plans	
	2012 $	2011 $	2012 $	2011 $
Accrued benefit obligation				
Balance - beginning of year	46,731	47,035	6,276	14,566
Current service cost	915	849	64	1,160
Interest cost	2,454	2,769	265	843
Partial curtailment of liability	-	-	-	(11,948)
Past service cost	-	446	-	(3,687)
Benefits and expenses paid	(2,394)	(1,866)	(301)	(294)
Actuarial loss (gain)	3,166	(2,502)	215	5,636
Balance - End of year	**50,872**	**46,731**	**6,519**	**6,276**
Plan assets				
Fair value - beginning of year	42,716	38,979	-	-
Actual return on plan assets	2,403	2,720	-	-
Contributions	3,692	3,692	301	294
Benefits and expenses paid	(2,394)	(1,866)	(301)	(294)
Actuarial gain (loss) on plan assets	657	(809)	-	-
Fair value - end of year	47,074	42,716	-	-
Funded Status – plan deficit	(3,798)	(4,015)	(6,519)	(6,276)
Unamortized net actuarial loss / (gain)	2,439	(22)	770	565
Accrued benefit liability	**(1,359)**	**(4,037)**	**(5,749)**	**(5,711)**

(in thousands of Bermuda dollars except share and per share amounts)

ii) Asset allocation

The asset allocation by major category for the defined benefit pension plan is as follows:

	2012 %	2011 %
Equities	11	9
Fixed income	65	71
Real estate	8	5
Other	16	15
Total	**100**	**100**

iii) Actuarial assumptions

The significant actuarial assumptions adopted in measuring the Group's accrued benefit obligations vary depending on whether the obligation is the result of Bermuda or Barbados based operations. Those assumptions are as follows (weighted-average assumptions as of 31 December 2012 and 2011):

	Defined benefit pension plans		Medical benefit plans	
	2012 %	2011 %	2012 %	2011 %
Bermuda				
Benefit cost during the year:				
Discount rate	4.25	5.00	5.25	6.00
Expected long-term rate of return on plan assets	5.00	7.00		
Rate of compensation increase	3.75	4.75		
Accrued benefit obligation at end of year:				
Discount rate	3.50	4.25	3.00	5.25
Compensation increase	3.00	3.75		
Post-retirement indexation	0.00	0.00		

The expected return on assets assumption for pension cost purposes is the weighted average of expected long-term asset return assumptions by asset class, and is selected from a range of possible future asset returns.

For measurement purposes, the annual rate of increase in the per capita cost of covered health care benefits was assumed to be 8.5% for years 2012 to 2013, 6.5% for years 2014 to 2018, and 4.5% thereafter.

(in thousands of Bermuda dollars except share and per share amounts)

	Defined benefit pension plans		Medical benefit plans	
	2012	2011	2012	2011
	%	%	%	%
Barbados				
Benefit cost during the year:				
Discount rate	7.75	7.75	7.75	7.75
Expected long-term rate of return on plan assets	6.50	6.50		
Rate of compensation increase	6.00	6.00		
Accrued benefit obligation at end of year:				
Discount rate	7.75	7.75	7.75	7.75
Compensation increase	6.00	6.00		
Post-retirement indexation	2.50	2.50		

Medical premium inflation in Barbados was assumed to be 6% (2011 – 6%).

iv) Expense recognized in consolidated statement of income

The Group's net benefit plan expense is as follows:

	Defined benefit pension plans		Medical benefit plans	
	2012	2011	2012	2011
	$	$	$	$
Current service cost	915	849	64	1,160
Interest cost	2,454	2,769	265	843
Expected return on plan assets	(2,403)	(2,720)	-	-
Net actuarial losses recognized during the year	47	9	10	6,042
Past service cost (credit)	-	446	-	(3,687)
Gains on curtailment and settlements	-	-	-	(11,948)
Difference between recognized and actual actuarial loss	-	-	-	-
Benefit plan expense (gain)	1,013	1,353	339	(7,590)
Gain recognized on partial curtailment of medical benefit plans	-	-	-	9,629
Net benefit plan expense	**1,013**	**1,353**	**339**	**2,039**

v) Impact of changes in actuarial assumptions

Pension and health care cost calculations are based on trend rate assumptions which may differ from actual results. Changes in trend rate assumptions by 1% in either direction will change the retirement benefit obligation as follows:

	Defined benefit pension plans		Medical benefit plans	
	Increase	Increase	Decrease	Decrease
	2012	2011	2012	2011
	$	$	$	$
Aggregate of current service cost and interest cost	387	1,031	(283)	(716)
Accrued benefit obligation	7,392	7,079	(5,796)	(5,606)

(in thousands of Bermuda dollars except share and per share amounts)

15. PROPERTY AND EQUIPMENT

	Land and buildings $	Furniture, equipment and leasehold improvements $	Computer hardware $	Motor Vehicles $	Total $
At 1 January 2011					
Cost	13,685	7,282	6,604	-	27,571
Accumulated amortization	(2,087)	(5,692)	(5,366)	-	(13,145)
Net book amount	**11,598**	**1,590**	**1,238**	**-**	**14,426**
Year ended 31 December 2011					
Additions	-	344	429	-	773
Disposals	(337)	-	-	-	(337)
Amortization charge	(239)	(544)	(519)	-	(1,302)
Closing net book amount	**11,022**	**1,390**	**1,148**	**-**	**13,560**
At 31 December 2011					
Cost	13,348	7,626	7,033	-	28,007
Accumulated amortization	(2,326)	(6,236)	(5,885)	-	(14,447)
Net book amount	**11,022**	**1,390**	**1,148**	**-**	**13,560**
Year ended 31 December 2012					
Acquired fixed assets	-	1,087	154	51	1,292
Additions	22	512	418	12	964
Disposals	-	(365)	(104)	-	(469)
Disposals – accumulated amortization	-	367	104	-	471
Amortization charge	(235)	(768)	(495)	(22)	(1,520)
Closing net book amount	**10,809**	**2,223**	**1,225**	**41**	**14,298**
At 31 December 2012					
Cost	13,370	8,860	7,501	63	29,794
Accumulated amortization	(2,561)	(6,637)	(6,276)	(22)	(15,496)
Net book amount	**10,809**	**2,223**	**1,225**	**41**	**14,298**

As security for the term loan agreement entered into in connection with the acquisition of IHHL, the Lender holds a first mortgage over the building held within BF&M Properties.

(in thousands of Bermuda dollars except share and per share amounts)

16. INVESTMENT PROPERTIES

	2012 $	2011 $
Cost	54,496	54,256
Accumulated amortization	(13,902)	(12,972)
Net book amount	**40,594**	**41,284**
Year ended 31 December		
At beginning of year	41,284	41,963
Net additions and capital improvements	240	315
Amortization	(930)	(994)
Closing net book amount	**40,594**	**41,284**

Investment properties consist of the Aon House (formerly ACE Tempest Re Building), owned by Scarborough, a 60% owned subsidiary, and Argo House (formerly PXRE House), owned by Barr's Bay, a 60% owned subsidiary. The minority shareholder of Barr's Bay holds an equitable mortgage as security for its loan to Barr's Bay. As security for the term loan agreement entered into in connection with the acquisition of IHHL, the Group has entered into a Deed of Assignment over BF&M Properties' 60% ownership interest in Scarborough. Additional investment properties located in Barbados include land being used for car parking facilities and two buildings being used for rental. One of the Barbados properties has been placed in trust with respect to the Statutory funds and if this was to be sold the value of the asset would need to be replaced within the statutory fund.

At 31 December 2012, investment properties with a net book value of $40,594 (2011 - $41,284) were estimated to be valued at $74,126 (2011 - $74,741) on the basis of their estimated open market value for existing use. This value is based on the most recent formal appraisal which was performed in 2010 for Bermuda and 2012 for the Barbados based properties.

Operating expenses incurred in support of generating rental income from investment properties was $2,252 (2011 - $2,045).

(in thousands of Bermuda dollars except share and per share amounts)

17. INTANGIBLE ASSETS

The carrying amounts of intangible assets are as follows:

	Finite life				Indefinite life		
	Customer relationships & contracts $	Distribution channels $	IHHL brand $	Software development coats $	ICBL brand $	Goodwill $	Total $
At 1 January 2011							
Cost	11,923	-	-	19,029	697	2,628	34,277
Accumulated amortization	(6,652)	-	-	(2,259)	-	-	(8,911)
Net book value	5,271	-	-	16,770	697	2,628	25,366
Year ended 31 December 2011							
Opening net book value	5,271	-	-	16,770	697	2,628	25,366
Additions	-	-	-	3,059	-	-	3,059
Amortization	(1,216)	-	-	(1,942)	-	-	(3,158)
Impairment losses	(729)	-	-	-	-	-	(729)
Closing net book value	3,326	-	-	17,887	697	2,628	24,538
At 31 December 2011							
Cost	11,194	-	-	22,088	697	2,628	36,607
Accumulated amortization	(7,868)	-	-	(4,201)	-	-	(12,069)
Net book value	3,326	-	-	17,887	697	2,628	24,538
Year ended 31 December 2012							
Opening net book value	3,326	-	-	17,887	697	2,628	24,538
Acquired intangibles & goodwill	1,300	14,500	2,000	70	-	7,700	25,570
Additions	-	-	-	2,308	-	-	2,308
Amortization	(1,111)	(1,087)	(300)	(2,123)	-	--	(4,621)
Closing net book value	**3,515**	**13,413**	**1,700**	**18,142**	**697**	**10,328**	**47,795**
At 31 December 2012							
Cost	12,494	14,500	2,000	24,466	697	10,328	64,485
Accumulated amortization	(8,979)	(1,087)	(300)	(6,324)	-	-	(16,690)
Net book value	**3,515**	**13,413**	**1,700**	**18,142**	**697**	**10,328**	**47,795**
Remaining amortization period in years	2.8 years	9.3 years	4.3 years	7.4 years	n/a	n/a	

Customer lists

During 2004, the Group purchased rights to certain customer lists in the health, life, annuity and pension business. During 2007, the Group purchased rights to another customer list in the amount of $1,215. During 2011, the Group deemed these lists to be impaired and recognized an impairment of $729.

Software development costs

The Group is engaged in significant development of its new core information systems. Costs associated with the development of the system are deferred, to the extent that the cost satisfies the criteria under *IAS 38 – Intangible assets*, until such time that management determines that a component is available for use in the manner expected and then it is amortized over its useful life. Annually, the Group reviews its software development costs for evidence of impairment.

(in thousands of Bermuda dollars except share and per share amounts)

ICBL intangibles

In 2005, the Group acquired intangible assets arising from the ICBL acquisition including the ICBL brand and customer relationships totalling $5,783. Of the total intangible assets acquired, $5,086 was identified as the value of intangible assets that have finite lives and are amortized over 10 years, being the estimated expected lives of the existing relationships. The remaining balance of $697 relates to the ICBL brand and was determined to have an indefinite life.

IHHL intangibles

In 2012, the Group acquired intangible assets arising from the IHHL acquisition including the IHHL brand, customer lists, agent relationships, and software development costs totalling $17,870. All intangibles were identified as having finite lives and are amortized over either 5 years (brand) or 10 years (customer lists, agent relationships, and software development costs).

Goodwill

Goodwill represents the excess of the cost of ICBL and IHHL at acquisition over the fair value of the net assets acquired. The entire balance of goodwill is therefore fully allocated to the Barbados and Cayman operations which are identified as separate operating segments. When testing for impairment, the recoverable amount of ICBL and IHHL is determined based on its fair value less costs to sell. Impairment of these intangibles is assessed on an annual basis.

18. INCOME TAXES

Income tax is calculated and payable on the profits of ICBL, BF&M Canada and IHHL which operate in jurisdictions with corporate tax requirements. The rest of the Group operates in non-corporate tax jurisdictions.

A. INCOME TAX

The income tax expense comprises:

	2012 $	2011 $
Current tax	849	1,466
Deferred tax	(372)	76
Total income tax expense	**477**	**1,542**

The taxation charge on taxable income differs from the theoretical amount that would arise using the applicable tax rates as follows:

	2012 $	2011 $
ICBL, BF&M Canada and IHHL's income before corporation tax	10,332	7,750
Tax calculated at effective rates of 25%*, 35% and 37.4% respectively	1,326	1,980
Prior year adjustments	(179)	-
Effect of different tax rates on taxable income	(465)	374
Income not subject to tax	(90)	(83)
Tax effect of other amounts allowed	(145)	(975)
Expenses not deductible for tax	90	175
Tax (over)/under accrual	(60)	71
Total income tax expense	**477**	**1,542**

*ICBL's life business is subject to tax at a rate of 5% of gross investment income. All other investment income of ICBL is subject to tax at a rate of 12.5%.

(in thousands of Bermuda dollars except share and per share amounts)

B. DEFERRED TAXES

The deferred tax asset and deferred tax liability relate to the following items. Items with right of offset are presented on a net basis.

	2012 $	2011 $
Deferred tax assets:		
Taxable losses carried forward	672	-
Net unearned premium	173	-
Deferred ceding commissions	913	-
Outstanding claims	14	-
Deferred acquisition costs	(798)	-
Deferred tax asset	**974**	**-**
Deferred tax liabilities:		
Accelerated tax depreciation	(132)	(109)
Net pension plan asset	(482)	(318)
Deferred tax liability	**(614)**	**(427)**

C. TAX RECOVERABLE

	2012 $	2011 $
Tax recoverable at beginning of year	1,687	2,192
Acquired tax recoverable	343	-
Tax payments made	1,368	903
Tax under accrual	-	58
Current tax expense for year	(849)	(1,466)
Tax recoverable at end of year	**2,549**	**1,687**

(in thousands of Bermuda dollars except share and per share amounts)

19. OTHER LIABILITIES

These include:

	2012 $	2011 $
Payables and accrued expenses	24,838	20,243
Insurance balances payable	18,612	9,043
Deferred commission income	14,559	5,979
Policyholder dividends payable	5,593	5,823
Dividends payable	1,695	1,677
Total	**65,297**	**42,765**

Insurance balances payable include amounts payable to reinsurers and brokers.

20. LOANS PAYABLE

Loans payable consist of:

	2012 $	2011 $
Loans payable	3,107	3,715
Bank borrowing	22,750	-
Total loans payable	**25,857**	**3,715**

Estimated principal repayments on the loans payable balance of $25,857 (2011 - $3,715) for the next five years are as follows:

	$
2013	7,716
2014	7,711
2015	7,818
2016	2,372
2017	240
	25,857

	2012 $	2011 $
Current liability portion (payable within 12 months)	7,716	645
Long-term liability portion	18,141	3,070
Total	**25,857**	**3,715**

The carrying amounts for the current liability portion of the loans disclosed above reasonably approximate fair value at the reporting date.

(in thousands of Bermuda dollars except share and per share amounts)

A. LOANS PAYABLE

In prior years, the Group borrowed $6,934 from an affiliated Company of the minority shareholder of Barr's Bay, against the $7,000 in promissory notes available to finance the construction of Argo House.

Interest on the variable rate loan is adjusted quarterly at the lower of 7% or 2% less than the average of the prevailing per annum first mortgage rates of banks in Bermuda. Interest accrues on the date of each drawdown and is payable on the last day of each calendar quarter commencing one year after completion of the building but only to the extent that Barr's Bay has cash surplus to its needs arising from income in excess of all operating expenses (including payments of interest). Accrued interest on the loan at 31 December 2012 was $36 (2011 - $44). Repayment of accrued interest is made separately, and began in the year 2006. Repayment of loan principal commenced in the year 2005 and it is anticipated that the loan will be fully repaid by 30 June 2017 (contract maturity – 1 January 2026). During the year $645 (2011 - $664) of the principal balance was repaid.

The fair value of the Barr's Bay loan with a minority shareholder does not approximate its fair value as it pays an interest rate of 2% below the average of the prevailing First Mortgage rates of banks in Bermuda. To estimate fair value, the expected cash flows of the loan have been discounted using a market interest rate. The fair value of the loan at 31 December 2012 is $2,995 (2011 - $3,576).

B. BANK BORROWING

During the year, the Group entered into a term loan agreement in connection with the acquisition of IHHL on 30 March 2012. Full details on the acquisition are provided in Note 27. Under the terms of the agreement, the Group borrowed $28,000 (Twenty eight million dollars) to be repaid in 16 equal quarterly installments of $1,750 payable on 30 June, 30 September, 31 December and 31 March of each year commencing on 30 June 2012. Interest on the loan is at 2.5% above Libor and is payable on the last day of each calendar quarter commencing on 30 June 2012. During the year, $5,250 of the principal balance was repaid.

21. SHARE CAPITAL

	2012 $	2011 $
Authorized -		
10,000,000 (2011 - 10,000,000) common shares of a par value of $1 each	10,000	10,000
Issued and fully paid -		
Common shares of a par value of $1 each	8,477	8,385

Common shares in issue in the Group rank pari passu with any new common shares issued in the Group. All the common shares in issue carry the same right to receive all dividends and other distributions declared, made or paid by the Group.

(in thousands of Bermuda dollars except share and per share amounts)

A reconciliation of the number of shares outstanding at the beginning and at the end of the period is as follows:

	2012 # of shares	2011 # of shares
At 1 January	8,384,746	8,370,294
Shares issued under the employee share purchase plan	11,700	10,671
Shares issued under the equity incentive plan	7,381	7,381
Stock grants issued under the equity incentive plan	73,143	-
Stock grants forfeited under the equity incentive plan	-	(3,600)
At 31 December	**8,476,970**	**8,384,746**

Share premium and contributed surplus
Share premium comprises additional paid in capital in excess of the par value. This reserve is not ordinarily available for distribution. Contributed surplus represents additional paid in capital.

Accumulated other comprehensive loss
This consists of translation adjustments arising from the consolidation of the BF&M Canada operations and unrealized gains and losses on available for sale financial assets.

Employee share purchase plan
Under the plan 250,000 shares have been made available for employee share purchase. As at 31 December 2012, 234,110 shares had been purchased (2011 – 222,410). During the year 11,700 (2011 – 10,671) shares were issued. The fair value of the shares amounted to $181 (2011 - $158) which was credited to share capital and share premium. The discount of $27 (2011 - $24) was charged to compensation expense.

Shares held by the Group's defined benefit pension scheme
As at 31 December 2012, 55,992 (2011 – 55,992) shares of the Group were owned within the investment portfolio of the Group's defined benefit pension scheme.

A. EQUITY INCENTIVE PLAN

i) Stock options
The stock options granted have a ten-year term and vest to the grantees over a three-year period. The following table summarizes the stock options issued under the Group's Equity Incentive Plan:

	# of options	2012 Weighted average exercise price	# of options	2011 Weighted average exercise price
Outstanding at beginning of year	177,576	16.39	184,957	16.82
Exercised	(7,381)	8.97	(7,381)	6.76
Forfeited	-	-	-	-
Outstanding at end of year	170,195	17.60	177,576	16.39
Exercisable at 1 January 2013 and 2012	170,195	17.60	177,576	16.39

(in thousands of Bermuda dollars except share and per share amounts)

The following table summarizes information about stock options outstanding at year-end:

Stock options expiring 1 January	# of options outstanding	# of options exercisable at 1 January 2013	Exercise price $
2014	16,473	16,473	10.50
2015	-	-	13.43
2016	51,122	51,122	16.19
2017	50,600	50,600	16.82
2018	52,000	52,000	22.00
	170,195	**170,195**	

ii) Restricted stock grants and restricted units

During the year 73,143 (2011 – 0) common shares and 10,525 units (2011 – 0) were issued to certain key employees in respect of restricted stock grants and restricted unit grants. These are held by the Group and are restricted from sale or use by the employees for three years from the grant date. Restricted unit grants differ from restricted stock grants in that no common shares are issued at the time of the grant; instead they are issued after the vesting date. The amount of the benefit to these key employees totalled $1,339 (2011 – $0) and will be amortized through earnings over a three year period. The amount charged to compensation expense in the current year totalled $327 (2011 – $52).

The following table summarizes information about the outstanding stock and unit grants:

Restricted stock and unit grants vesting	# of shares	# of units
1 January 2013	22,154	-
1 January 2014	-	-
1 January 2015	62,187	10,525
Total	84,341	10,525

(in thousands of Bermuda dollars except share and per share amounts)

B. EARNINGS PER SHARE

Basic earnings per share is calculated by dividing the shareholders' net earnings for the year by the weighted average number of ordinary shares outstanding at the reporting date.

Diluted earnings per share is calculated by dividing the shareholders' net earnings by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	2012			2011		
	Income $	# of weighted average shares	per share amount $	Income $	# of weighted average shares	per share amount $
Net earnings	21,503			32,740		
Basic earnings per share: Income available to common shareholders	21,503	8,423,635	2.55	32,740	8,377,520	3.91
Effect of dilutive securities: Stock options		5,271			7,505	
Diluted earnings per share: Income available to common shareholders and assumed conversions	21,503	8,428,906	2.55	32,740	8,385,025	3.90

The weighted average number of shares used in the calculation of diluted earnings per share for 2012 excludes 29,089 (2011 – 39,232) share options granted to employees of the Group, as these would have been anti-dilutive. There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these consolidated financial statements.

22. COMMISSION AND OTHER INCOME

This includes commission earned from reinsurers and fee income from the management of segregated funds assets, pension administration and investment management services.

	2012 $	2011 $
Commission income	37,485	15,776
Fees earned from management of insurance contracts	2,778	1,034
Fees earned from management of investment contracts	550	1,653
Pension administration income	3,299	3,550
Fee income	3,010	2,284
Total	**47,122**	**24,297**

(in thousands of Bermuda dollars except share and per share amounts)

23. INSURANCE CONTRACTS BENEFITS AND EXPENSES

	2012 $	2011 $
Gross life and health claims and benefits paid	101,875	103,271
Reinsurance recoveries	(5,782)	(6,617)
Change in insurance contract liabilities	10,162	21,947
Change in reinsurance assets	(991)	(3,241)
Total life and health policy benefits	**105,264**	**115,360**
Gross short term claim and adjustment expenses paid	34,864	30,621
Reinsurance recoveries	(12,115)	(14,101)
Change in insurance contract liabilities	(6,555)	1,633
Change in reinsurance assets	2,021	(2,445)
Total short term claim and adjustment expenses	**18,215**	**15,708**
Total insurance contracts benefits and expenses	**123,479**	**131,068**

24. OPERATING EXPENSES

	2012 $	2011 $
Wages and salaries	34,825	30,628
Professional and consulting fees	6,577	6,346
Pension costs	4,159	(2,007)
Premium taxes	3,334	1,485
IT maintenance contracts	2,305	1,712
Advertising and business development	2,168	1,121
Bank charges and foreign currency purchase tax	1,904	1,179
Office rent	1,701	1,091
Acquisition related expenses	1,411	-
Share expense	354	76
Other post retirement expense	339	1,567
Other	4,004	6,067
Total	**63,081**	**49,265**

25. RELATED PARTIES

As disclosed in note 1, a number of the subsidiaries transacted with the Group during the year in the normal course of business. These transactions are eliminated on consolidation.

(in thousands of Bermuda dollars except share and per share amounts)

Key management personnel have been defined as the executive team and board of directors of the Group. The following transactions were carried out with key management:

A. SALES OF INSURANCE CONTRACTS AND OTHER SERVICES

	2012 $	2011 $
Sales of insurance contracts and pension services:		
- Key management	182	204
Purchase of services:		
- Key management	305	150

B. KEY MANAGEMENT COMPENSATION

The following table shows compensation to key management:

	2012 $	2011 $
Salaries and other short-term employee benefits	2,150	2,293
Post-employment benefits	125	130
Other long-term benefits	10	12
Share based payments	913	185
Total	**3,198**	**2,620**

Pursuant to Regulation 6.8 (3) of Section 11A of the Bermuda Stock Exchange Listing Regulations, the total interests of all directors and officers of the Group in the common shares of the Group at 31 December 2012 were 338,659 (2011– 298,663) shares. No rights to subscribe for shares in the Group have been granted to or exercised by any director or officer, other than those disclosed in note 21.

C. LOANS TO RELATED PARTIES

Loans are extended to key management of the Group (and their families) and to companies related to key management. These loans are collateralized by the property acquired with the proceeds of the loan. Mortgage terms are typically no more than 20 years in duration and interest rates are consistent with rates charged by the Group to non-related parties.

	2012 $	2011 $
At beginning of year	10,225	10,714
Loan repayments received	(1,157)	(1,247)
Interest charges	708	758
At end of year	**9,776**	**10,225**

26. MAINTENANCE OF NET WORTH AGREEMENT

On 17 March 2006, an agreement was signed between the Group and Bermuda International whereby the Group and Bermuda International desire to provide certain assurances to parties, who hold risk contracts with Bermuda International, with respect to the financial condition of Bermuda International. The Group will, in accordance with the terms of the agreement, ensure that Bermuda International has, at all times, sufficient net worth to meet any and all valid claims of the parties who hold risk contracts with Bermuda

(in thousands of Bermuda dollars except share and per share amounts)

International. The Group agrees that it shall ensure that Bermuda International has a net worth at least equal to required regulatory minimum capitalization under The Insurance Act 1978, amendments thereto, and related regulations. If Bermuda International falls below the minimum net worth amount it will notify the Group and the Group will provide funds to Bermuda International within 10 business days.

27. BUSINESS COMBINATIONS

On 30 March 2012, BF&M Limited acquired 100 percent of the common shares of Island Heritage Holdings, Ltd. ("IH Holdings"). IH Holdings' principal subsidiary is Island Heritage Insurance Company, Ltd., a leading Cayman Islands based company that writes property and casualty insurance in the Caribbean region. This acquisition has further strengthened the Group's position as a strong regional insurer in the Caribbean.

The acquired business contributed income of $29,921 and net income of $3,627 to the consolidated statement of comprehensive income since 30 March 2012. If the business combination had occurred on 1 January 2012, the Group would have reported income of $41,084 and earnings of $5,733.

Acquisition related expenses of $1,411 have been charged to operating expenses in the Group's consolidated statement of income.

The following table summarizes the consideration transferred to acquire IH Holdings and the amounts of identified assets acquired and liabilities assumed at the acquisition date. Certain balances have been disclosed to provide more meaningful information.

Fair value of total consideration transferred:	
Cash	**70,121**
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash and cash equivalents	36,486
Investments	20,679
Insurance receivables and other assets	32,856
Reinsurance assets	30,721
Property and equipment	1,292
Intangible assets	17,870
Tax recoverable	343
Deferred tax asset	415
Insurance contract liabilities	(40,943)
Other liabilities	(37,298)
Total identifiable net assets	**62,421**
Goodwill	**7,700**

The goodwill is attributable to the workforce of the acquired business and the synergies expected to arise with the Group's acquisition of IH Holdings.

The fair value of acquired receivables approximates its carrying value. The gross contractual amount of acquired receivables is equal to the net receivable except for premiums receivable, which is included within insurance receivables and other assets in the consolidated statement of financial position. The gross contractual amount of premiums receivables was $16,914 of which $425 was expected to be uncollectible.

The Group acquired a loan of $28,000 in order to assist with the purchase. The remaining cash consideration of $42,121 was funded from cash generated through ongoing operations. The term of the loan is 4 years, with an interest rate of 2.5% above LIBOR.

28. SUBSEQUENT EVENTS

On 18 March 2013, the Group declared a dividend to be paid to shareholders of record at 28 March 2013. The dividend was paid on 15 April 2013. $1,697 was paid out in total, representing a $0.20 dividend paid on 8,482,605 shares.

DIRECTORS AND OFFICERS OF PRINCIPAL OPERATING SUBSIDIARIES

BF&M GENERAL INSURANCE COMPANY LIMITED

DIRECTORS

Nancy L. Gosling, B.Comm., C.G.A. LL.D., *Chairman*
[1] **Peter N. Cooper,** *Deputy Chairman*
Gavin R. Arton
Gregory D. Haycock, FCA., J.P.
L. Anthony Joaquin, FCA
[2] **David A. J. G. White**
R. John Wight, C.A., CPCU
Glen P. Gibbons, B.A., A.C.I.I., Chartered Insurer

OFFICERS

R. John Wight, C.A., CPCU, *President & Chief Executive Officer*
Glen P. Gibbons, B.A., A.C.I.I., Chartered Insurer, *Senior Vice President*
Patrick Neal, B.A., CPCU, *Senior Vice President, Business Development*
Heather A. Bisbee, C.A., *Head of Financial Reporting*
Lynda A. Davidson Leader, B.A., C.A., *Vice President, Corporate Services*
Debby L. Graham, P.H.R., *Vice President, Human Resources*
Andrew Hanwell, *Vice President, Personal Insurance*
Henry Sutton, CPCU, ARe, *Vice President, Customer Relations*
Angela R. Tucker, C.A., *Vice President and Group Controller*

ACTUARIAL

Mylene Labelle, F.C.I.A., F.C.A.S., (Eckler Partners Limited, Toronto), *Consultant Actuary*

BF&M LIFE INSURANCE COMPANY LIMITED

DIRECTORS

Garry A. Madeiros, OBE, FCA., J.P., *Chairman*
Stephen W. Kempe, *Deputy Chairman*
Gavin R. Arton
Catherine S. Lord, B.Sc., J.P.
Ann B. Teixeira, LLIF
C.L.F. "Lee" Watchorn, F.C.I.A., F.S.A.
R. John Wight, C.A., CPCU
Susan M. Reed, B.A., FLMI

OFFICERS

R. John Wight, C.A., CPCU, *President & Chief Executive Officer*
Susan M. Reed, B.A., FLMI, *Chief Operating Officer*
Paul Matthews, B.A., FLMI, *Senior Vice President*
Patrick Neal, B.A., CPCU, *Senior Vice President, Business Development*
Heather A. Bisbee, C.A., *Head of Financial Reporting*
Gina A. Bradshaw, FLMI, *Vice President*
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[1] Retired May 2013
[2] Resigned April 2013

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NOTES

Head Office
Insurance Building | 112 Pitts Bay Road | Pembroke HM 08 | Bermuda
P. O. Box HM 1007 | Hamilton HM DX | Bermuda
Tel: 441-295-5566 | Fax: 441-292-8831 | www.bfm.bm

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