
# ANNUAL REPORT 2009

BF&M LIMITED

# Contents

# Mission Statement

To strengthen and further develop our position as Bermuda's leading insurer 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.

# Group Executive

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

**Susan Reed,** B.A., CLU, FLMI
Chief Operating Officer

**Janet Carew,** C.A.
Chief Financial Officer

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

**Lynne A. Woolridge,** BSc, FLMI
Senior Vice President
BF&M Life Insurance Company Limited

**Goulbourne Alleyne,** MBA, FCII
Vice President, Underwriting & Claims
BF&M General Insurance Company Limited

**Gina A. Bradshaw,** FLMI
Vice President, Corporate Strategy

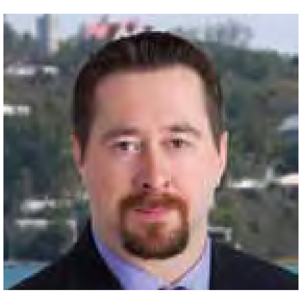
**Miguel DaPonte,** C.F.A., M.B.A.
Vice President
BF&M Investment Services Limited

**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

**Michael Lima**
Vice President & General Manager
Bermuda International Insurance Services Limited



**Paul Matthews,** B.A, PMP
Vice President, Information Technology

**Patrick Neal,** B.A, CPCU
Vice President, Bancassurance

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

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

# Directors

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

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

[2] **Nancy L. Gosling,** B.Com., 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 Managinig Partner, Ernst & Young

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

[3] **Catherine S. Lord,** B.Sc., J.P., Retired

[1] **Garry A. Madeiros,** FCA, J.P., Retired President & CEO, Belco Holdings Limited

[2] **R. Blake Marshall,** B.B.A., M.Sc., C.A., President, Raphael Limited

[1] **S. Caesar "Sy" Raboy,** CLU, Retired Senior Vice President & Deputy General Manager, Sun Life Assurance Company of Canada's U.S. Operation

[1,3] **Richard D. Spurling,** Retired Partner, Appleby, Barristers & Attorneys

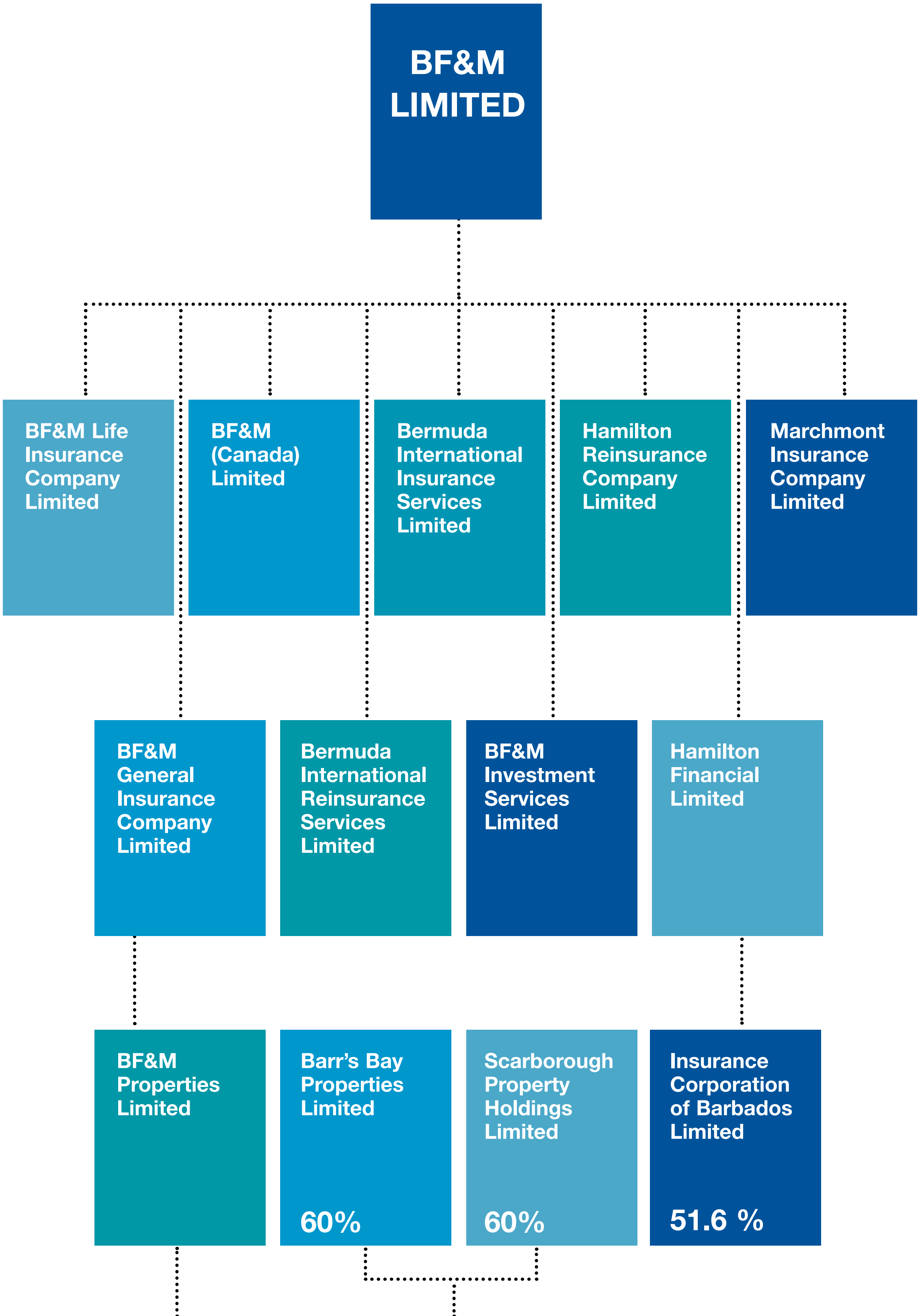
[2] **C.L.F. "Lee" Watchorn,** FCIA, FSA, President, Watchorn Advisory Group

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

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

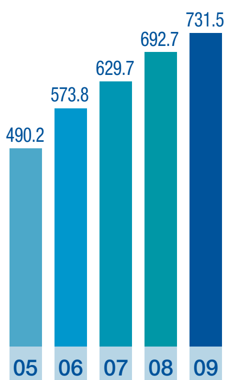
[1] Finance, Compensation & Corporate Governance Committee
[2] Audit, Compliance & Corporate Risk Management Committee
[3] Nominating Committee

# Corporate Structure

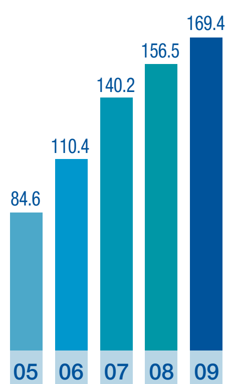


# Financial and Statistical Summary

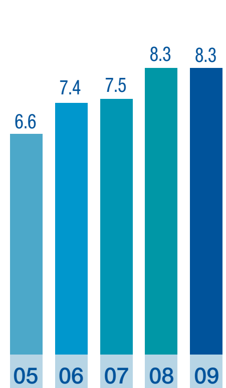
## END OF YEAR




**Total Assets**
*in millions of dollars*

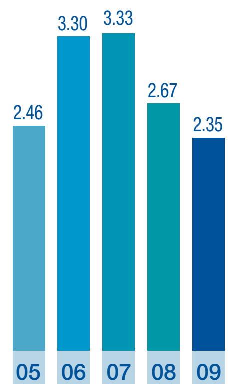



**Shareholders' Equity**
*in millions of dollars*

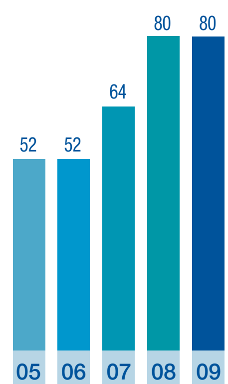



**Number of Common Shares**
*in millions*

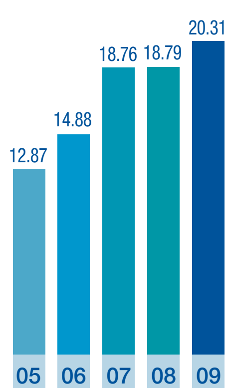
## PER COMMON SHARE




**Net Earnings**
*in dollars*

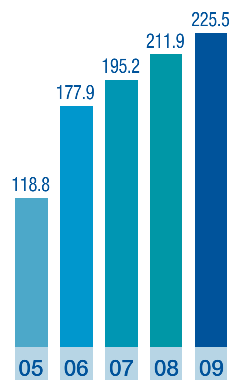



**Cash Dividends**
*in cents*

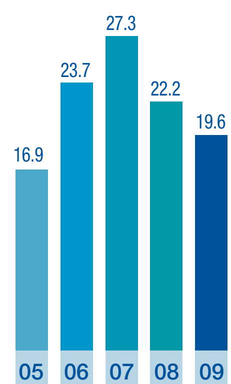



**Book Value**
*in dollars*

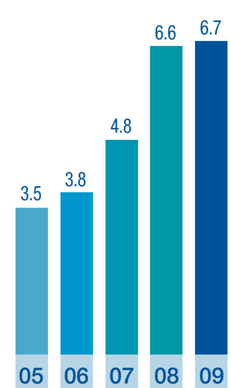
## FOR THE YEAR




**Gross Premiums Written**
*in millions of dollars*

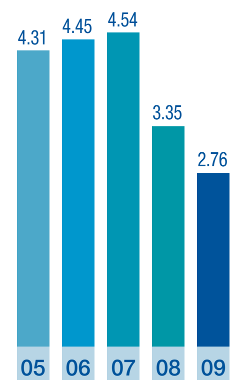



**Net Earnings**
*in millions of dollars*

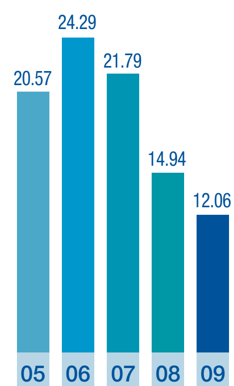



**Dividends Declared**
*in millions of dollars*

## FINANCIAL RATIOS




**Return on Assets**
*percentage*




**Return on Common Shareholders' Equity**
*percentage*

**Gavin R. Arton**
*Chairman*

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

# The Shareholders' Report

2009 was a challenging year for Bermuda as the global economic downturn affected the Island's businesses in every sector. Businesses employed fewer people, and individuals purchased fewer new cars, boats, and postponed building renovations. All of this contributed to less business volume for companies servicing Bermuda's insurance needs, and BF&M was not immune to the issues facing these businesses and individuals. Net earnings for BF&M Limited for the year ended 31st December, 2009 were $19.6 million. This compares with earnings of $22.2 million in 2008. These 2009 results represent a 12% return on equity for shareholders. At 31st December 2009 assets were $731.5 million and shareholders equity $169.4 million.

We were pleased that rating agency A.M. Best maintained their Financial Strength Rating "A" Excellent for BF&M's two principal operating companies BF&M Life Insurance Company Limited ("BF&M Life") and BF&M General Insurance Company Limited ("BF&M General"). 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 "A" Excellent rating rationale cited "the organization's consistently positive net income, steady premium growth, and strong capitalization". These "A" Excellent ratings for BF&M Life and BF&M General are the strongest of any local insurer in the Bermuda marketplace.

BF&M's investment performance was mixed in 2009. The fair value of assets in our trading portfolio decreased $3.4 million during the year. The majority of BF&M's investment balance of $264.3 million is in investment grade US dollar treasury securities, high credit quality corporate bonds, and First Bermuda mortgages. Our conservative investment policy served the company very well in 2008 when investment markets were volatile. However, our portfolio marginally underperformed benchmark indices in 2009 as many investors moved away from safer investments such as US treasuries that BF&M holds as part of a conservative investment portfolio. The results were also negatively impacted by BF&M's investment in local equities, which did not perform well. BF&M had no direct exposure to the sub prime mortgage market in 2009.

International Financial Reporting Standards (IFRS) will become a reality in 2011 for all publicly accountable enterprises that currently report under Canadian Generally Accepted Accounting Principles. As such BF&M Limited will report under IFRS starting in 2011 with comparative figures for 2010. BF&M supports the principles of transparency and uniformity of reporting that will result from the adoption of IFRS. However, the onetime start up costs were high in 2009 for a company our size. A project team was formed early in 2009 and BF&M will be ready on 1st January, 2011 to report under this new standard. We do not expect the effects of IFRS to have a material impact on BF&M's earnings due to changes in accounting principles.

A great deal of time and effort was expended in 2009 on the planned implementation of new information systems for certain lines of domestic insurance business starting in 2010. A dedicated team of operational staff, business analysts, information systems programmers and testers have been working diligently to ensure that, when implemented, the new systems will meet the needs of our businesses. In 2009 a decision was made by the company to write off approximately $4.6 million

# *Environment*

**BF&M is committed to the effort to make our Island community healthy, cleaner and more sustainable. In an effort to lead by example, we are trying to shrink our environmental footprint via several corporate green projects, actively getting involved with green charities and supporting global initiatives that promote making a difference.**

of development costs that had been incurred since 2007, due to uncertainty as to their future benefit. To be conservative the company decided to charge these costs against 2009 earnings.

The BF&M Insurance Group had seven profit centres for 2009 which we will report on as follows:

- **Bermuda General Insurance**
- **Bermuda Health & Life Insurance, Pension Administration Services**
- **Bermuda Asset Management**
- **Bermuda Real Estate**
- **Barbados Operation**
- **International Life Insurance**
- **International Life Reinsurance**

## Bermuda General Insurance

BF&M General enjoyed success in 2009 despite economic challenges as new building projects came to a standstill and the retail and hospitality sectors suffered. Despite the downturn in the local economy, gross premiums increased 3% year on year largely as a result of the success of our property account. Our ongoing relationship with HSBC Bermuda to deliver our insurance products to their customers contributed to growth in our home portfolio. Growth was also achieved by careful attention to service delivery while offering insurance solutions to customers.

Despite successfully increasing premiums in a competitive marketplace the claims experience was, unfortunately, the most severe since 2003 when Hurricane Fabian hit the island. Although there was an absence of major wind related claims in 2009, overall our gross claims before reinsurance recoveries increased 87% year on year or approximately $5 million. Profitability targets for our property and casualty lines of insurance were not met as a result of these high claims.

Profitability was down in our Motor account due to claims increasing 20% from 2008 combined with insured values down as a result of fewer new boat and automobile sales. We continue to monitor the motor account on a monthly basis to ensure that adverse trends are identified proactively. Additionally, we continue to work with repair businesses as we manage the claims expenses. Our focus on claims service and claims expense management is critical as we look to manage the motor portfolio to ensure it continues to contribute to the profitability of the company.

Our Reinsurance programme for 2009 was renewed on favourable terms and conditions. We continue to select world class reinsurance capacity to manage our ultimate loss exposure. We achieved a savings on the 2009 programme across all classes whilst maintaining the high quality of reinsurers that is vetted annually by the Group Reinsurance Security Committee.

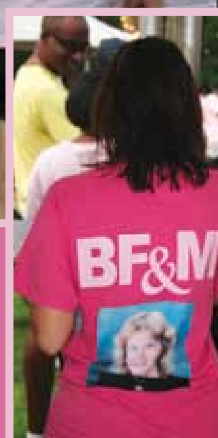
BF&M General remained focused on delivering a superior product while maintaining a differentiated level of customer service than our competitors. We remain focused on our guiding principles of Truth, Trust and Teamwork to ensure we deliver what is expected of us. Our willingness to work with our customers in hard times proved successful in 2009 and we carry momentum in to what we believe will be a challenging 2010 for Bermuda.

## Bermuda Health & Life Insurance, Pension Administration Services

Earnings from the health and life insurance lines of business were down overall from 2008 principally due to increasing claims and the trend of rising healthcare costs. We have been saying for several years that this trend remains a major concern for our company, our industry, and all Bermuda residents. Employer sponsored health plans in Bermuda account for approximately 40% of the overall BF&M Insurance Group

# BCHC Breast Cancer Walk






**One out of every eight women will be diagnosed with Breast cancer during her lifetime. With statistics like this, there is little wonder why BF&M has supported the Bermuda Cancer & Health Centre Breast Cancer Awareness Walk for 13 years.**

premium total. Group health claims increased 9.5% in 2009. Since 2006 profit as a percentage of gross premiums has decreased from 10.1% to 3.4%. With health care costs rising annually at the rate they are, we simply can't increase premiums to required levels each year to pay the increasing claims whilst maintaining the same levels of profitability.

Seniors' health insurance is a topical issue in Bermuda. BF&M is committed to Bermuda's senior population and this will not change in 2010. As long as individual policyholders enroll prior to age 69½ they remain covered with no reduction in benefits for the remainder of their lives. This is not a profitable line of business; in fact BF&M has lost money on seniors' individual health business for several years running. As a strong supporter of seniors in our community we are willing to accept this situation and we will continue to price health insurance premiums at a level that remains affordable to those seniors who need the benefits that private health insurance can provide. To further address the needs of Bermudian seniors we continue to partner with the organization Age Concern who distributes our insurance product called 'Peace of Mind'. This guaranteed life insurance product affords the Island's seniors the ability to ensure that their final expenses are taken care of, thus sparing their loved ones financial difficulty.

BF&M's wellness program continues to be utilized by many large employer groups. The program includes Health Risk Assessments, aggregate reporting analysis, customized employer-based-wellness program design, nurse consultancy and 24/7 online wellness website access. These services are offered free of charge. We continue to focus on Preventative Health through our benefit design. Several studies have shown that prevention reduces direct and indirect medical services costs over time.

As part of our effort to increase wellness awareness, we continue to promote personal accountability through our sponsorships such as the Bermuda Cancer & Health Breast Cancer Awareness Walk and health care consumer education through our quarterly publication of "Health Matters".

At an industry level, through the Health Insurers Association of Bermuda and Bermuda Health Council, BF&M promotes public & private involvement within the health sector. We provide valuable input to the Health Ministry and Bermuda Hospitals Board regarding domestic medical services needs, strategies to contain medical costs and tactics to improve billing practices and reduce administrative costs.

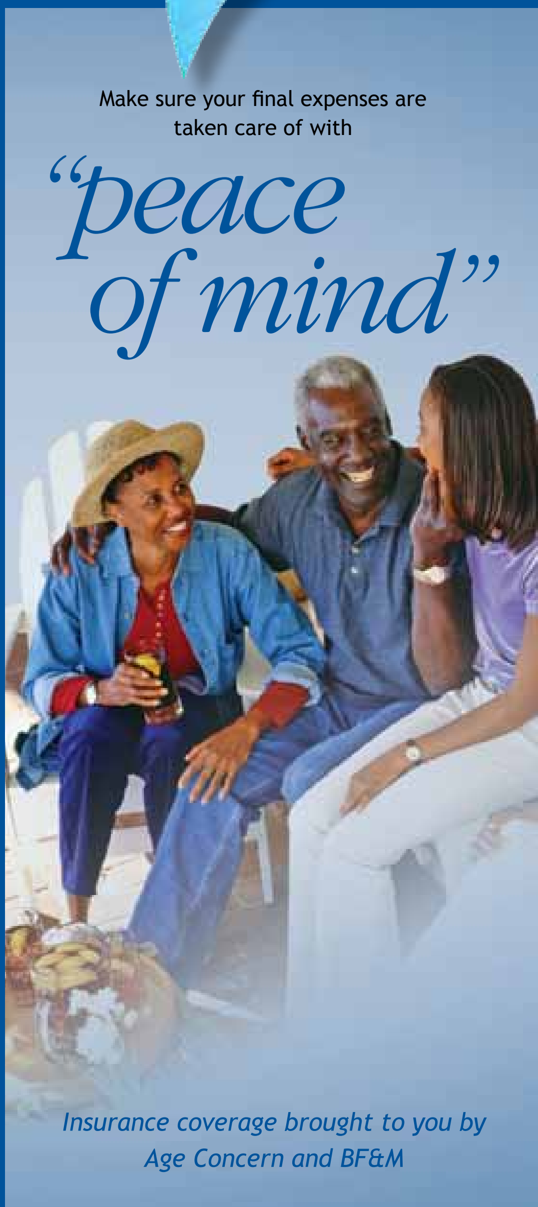
An ever increasing source of revenue for BF&M continues to be the administration of group and individual retirement plans. Only 5 years ago this division contributed moderately to our earnings but in 2009 accounted for approximately 50% of the earnings of the Life, Health, and Pensions combined business.

## Bermuda Asset Management

BF&M Investment Services Limited (formerly North Atlantic Asset Management Limited) 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. BF&M has distribution agreements with over thirty internationally recognized mutual fund managers and through these managers our clients have access to over ninety individual funds. Revenues in 2009 were consistent with 2008 although earnings were down slightly due to higher operating expenses.

AGE concern

towards a better life for seniors





**By partnering with the senior's advocacy group, Age Concern, BF&M aggressively seeks to find ways to offer specialized products to help address the current needs and future concerns of the island's elderly population.**

## Bermuda Real Estate

BF&M's 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 the Ace Tempest Re building and in Argo House. BF&M has temporarily housed our life agents and certain administrative staff in the Wessex House building on Church Street with plans underway to relocate these individuals to the Ace Tempest Re building in 2010 to improve operational efficiencies.

## Barbados Operation

The results of BF&M's 51.6% ownership interest in the Insurance Corporation of Barbados Limited ("ICBL") continue to benefit the group through geographical diversification. Earnings in 2009 improved over 2008 by 36%. The company, already the market leader in property and casualty insurance in Barbados, is developing and growing its life and health insurance business which will better balance the company for long term success.

Approximately 25% of BF&M's profits in 2009 were earned through the Company's ownership interest in ICBL. BF&M's investment in ICBL made in 2006 has both increased the profitability of BF&M and diversified overall geographic risk. ICBL recently received it's first ever A.M. Best rating of A – (Stable). There is no Barbados insurer writing domestic business with a higher rating.

## 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 global financial crisis had a major impact on the development of new business for all insurance carriers in the offshore life insurance business in 2009. We remain confident that our expertise and product offerings combined with the protection that Segregated Accounts legislation provides in Bermuda will differentiate us from our competition. We have recently partnered with a major international financial services group to develop a custom series of products for their North American and international clients.

## 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 America markets. IRM is a leading reinsurance management company which conducts reinsurance operations in 27 countries. An accounting loss was recorded in 2009 however IRM have a long and distinguished history of generating underwriting profits and we are confident of long term success in this marketplace.

## People and Community

There were several Management changes in 2009. Heather Bisbee, Vice President of Finance stepped down and was replaced by BF&M's new Chief Financial Officer Janet Carew, a Chartered Accountant with extensive experience both locally and overseas who will play an important role in the further development of our businesses. We were very pleased to announce the promotion of Holly Flook to Vice President, Underwriting & Claims of life and health business. Holly's knowledge is critical in addressing health care reform in Bermuda which she does as a senior manager at BF&M but also through her role as President of the Health Insurers Association of Bermuda. Paul Matthews was promoted to Vice President, Information Technology. Paul is based in our office in Canada and has many years of experience in the Canadian marketplace in this critical area of our business. After nearly 40 years of dedicated service to BF&M, Ross Hillen retired as Vice President, Underwriting & Claims for the General Insurance business. Ross is very well known in the local insurance community and played a significant role in the ongoing success of BF&M General. We wish him all the best in his well earned retirement. Ross was replaced by Goulbourne Alleyne, a seasoned senior underwriter with managerial experience in the Caribbean marketplace. Also during 2009, Andrew Hanwell was promoted to Assistant Vice President, Personal Insurance. Andrew helped develop a culture of customer service for clients with general insurance needs, and this promotion was very popular with staff who have learned from him. After a long period of employment, Vince Chaves left BF&M and we wish him well in his future endeavours.

Through a wide range of philanthropic programs BF&M made a meaningful difference to the community in 2009. Through our sponsorship of the 100 Day Challenge, St. George's Weight Handicap 5K Fitness Walk/Run and the Bermuda Cancer and Health Centre's Breast Cancer Awareness Walk, BF&M has encouraged Bermuda residents to take a proactive approach to their health and wellness.

Our support of the Bermuda Cricket Board and their various teams helps to ensure that a beloved local sporting tradition continues to delight, inspire and provide opportunities to Bermuda's next generation of cricketers. BF&M is committed to supporting the development of Bermuda's youth through participation in team sports, and what better sport then cricket to teach these young men and women important life skills such as teamwork and discipline.

Many of you may be reading this report online for the first time. Being environmentally conscious is important to our employees and makes good business sense. Wherever feasible we use recycled paper for our Annual Reports and calendars. Conducting business with BF&M online at www.bfm.bm saves paper and improves service to those policyholders who choose to renew or take out new policies for home, motor, marine, and travel insurance conveniently and without the need for paper. Starting in 2010 shareholders can choose to receive their communications electronically. We are very proud that BF&M has been recognized in our community as a leader in environmental awareness.

## Looking Forward

2009 was clearly a challenging year for the company, particularly with the backdrop of a global recession that is currently affecting Bermuda and which we expect will continue to do so well into 2010. We have dedicated staff and a well experienced management team backed by a supportive Board of Directors. We have proven that even during the difficult economic times experienced in Bermuda and internationally in 2008 and 2009 we were able to generate financial returns commensurate with those of high performing companies. We look forward to 2010 and beyond with great enthusiasm and expectations for continued success for our staff, policyholders and shareholders.

**Gavin R. Arton**
*Chairman*

R. John Wight

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


# BF&M LIMITED Financial Statements

# RESPONSIBILITY FOR FINANCIAL REPORTING

For the year ended 31st December, 2009

The Management of BF&M is responsible for the preparation of the consolidated financial statements contained in this report. These financial statements have been prepared in accordance with accounting principles generally accepted in Bermuda and Canada.

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.

The Audit, Compliance, and Corporate Risk Management Committee, composed of directors who are not officers or employees of the Company, reviews the 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 Company in accordance with auditing standards generally accepted in Bermuda and Canada and has expressed its opinion in its report to the Company's shareholders. The auditors have unrestricted access to and meet periodically with the Audit, Compliance, and Corporate Risk Management Committee to review their findings regarding internal controls over the financial reporting process, auditing matters and reporting issues.

R. John Wight

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

**Janet A. Carew,** C.A.
Chief Financial Officer,
7th April, 2010

# AUDITORS' REPORT TO THE SHAREHOLDERS

We have audited the consolidated balance sheet of BF&M Limited ('the Company') and the consolidated statement of segregated funds net assets as at 31st December, 2009 and the consolidated statements of earnings, comprehensive income, shareholders' equity and cash flows of the Company and the consolidated statement of changes in segregated funds net assets for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in Bermuda and Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company and the segregated funds net assets as at 31st December, 2009 and the results of the Company's operations and cash flows and the changes in the segregated funds net assets for the year then ended in accordance with accounting principles generally accepted in Bermuda and Canada.

PricewaterhouseCoopers

Chartered Accountants
7th April, 2010

# CONSOLIDATED BALANCE SHEET

As at 31st December, 2009

| | 2009 $ | 2008 $ |
|---|---|---|
| **ASSETS** | | |
| Investments (note 4) | **264,349,043** | 248,959,182 |
| Segregated funds with a guaranteed return | **242,552,271** | 221,793,628 |
| Cash and short-term deposits | **58,252,701** | 48,102,581 |
| Insurance balances receivable | **29,871,393** | 30,473,517 |
| Deferred policy acquisition costs | **1,790,786** | 1,437,435 |
| Reinsurers' share of: | | |
| Claims provisions (note 7) | **18,135,428** | 17,894,725 |
| Unearned premiums | **17,515,285** | 17,638,971 |
| Provision for participating policy benefits | **63,861** | 156,697 |
| Accounts receivable and other (notes 10 and 11) | **22,954,677** | 25,396,524 |
| Property, plant and equipment (note 6) | **54,973,212** | 56,007,951 |
| Goodwill | **2,628,848** | 2,628,848 |
| Intangible assets (note 12) | **18,449,577** | 22,217,009 |
| | **731,537,082** | 692,707,068 |
| **SEGREGATED FUNDS WITH NO GUARANTEED RETURN ASSETS** | **336,911,961** | 283,328,695 |
| **LIABILITIES** | | |
| Provision for claims and adjustment expenses (note 7) | **66,861,723** | 68,008,339 |
| Provision for future policy benefits (note 8) | **120,819,330** | 115,665,149 |
| Segregated funds with a guaranteed return | **242,552,271** | 221,793,628 |
| Claims payable | **2,595,062** | 2,718,421 |
| Insurance balances payable | **6,637,200** | 6,594,567 |
| Unearned premiums | **40,028,070** | 40,943,563 |
| Deferred commission income | **5,321,672** | 5,265,299 |
| Accounts payable and other (notes 10 and 11) | **31,541,993** | 30,799,537 |
| Loans payable (note 9) | **4,999,728** | 5,533,562 |
| Non-controlling interests | **40,760,301** | 38,901,087 |
| | **562,117,350** | 536,223,152 |
| **SHAREHOLDERS' EQUITY** | | |
| Share capital (note 13(a)) | **8,339,970** | 8,327,193 |
| Contributed surplus | **1,409,705** | 1,299,466 |
| Share premium | **56,693,299** | 56,535,475 |
| Accumulated other comprehensive loss | **(1,336,784)** | (1,012,605) |
| Retained earnings | **104,313,542** | 91,334,387 |
| | **169,419,732** | 156,483,916 |
| | **731,537,082** | 692,707,068 |
| **SEGREGATED FUNDS WITH NO GUARANTEED RETURN LIABILITIES** | **336,911,961** | 283,328,695 |

Gavin R. Arton, *Chairman*

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

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

# CONSOLIDATED STATEMENT OF EARNINGS

For the year ended 31st December, 2009

| | **2009** **$** | 2008 $ |
|---|---|---|
| **INCOME** | | |
| Gross premiums written | **225,507,351** | 211,882,319 |
| Reinsurance ceded | **(61,996,696)** | (60,964,318) |
| Net premiums written | **163,510,655** | 150,918,001 |
| Net change in unearned premiums | **791,808** | (1,157,721) |
| Net premiums earned | **164,302,463** | 149,760,280 |
| Investment income (note 4(c)) | **13,360,075** | 14,713,394 |
| Commissions and other income | **24,050,160** | 24,239,950 |
| Rental income | **4,842,975** | 4,602,458 |
| | **206,555,673** | 193,316,082 |
| **EXPENSES** | | |
| Claims and adjustment expenses | **18,696,599** | 20,143,994 |
| Policy benefits | **97,971,270** | 90,025,498 |
| Total paid or credited to policyholders | **399,224** | 1,592,182 |
| Commission expense | **9,649,873** | 8,514,985 |
| Operating expense | **43,378,461** | 40,016,009 |
| Amortization | **8,366,454** | 4,081,480 |
| Interest on loans | **199,954** | 260,249 |
| Non-controlling interests | **5,405,382** | 4,251,315 |
| | **184,067,217** | 168,885,712 |
| **EARNINGS BEFORE INCOME TAXES** | **22,488,456** | 24,430,370 |
| Income taxes (note 11(b)) | **2,747,400** | 2,365,179 |
| **NET EARNINGS FOR THE YEAR** | **19,741,056** | 22,065,191 |
| Participating policyholders' net (gain) loss | **(92,836)** | 105,876 |
| **SHAREHOLDERS' NET EARNINGS** | **19,648,220** | 22,171,067 |
| **EARNINGS PER SHARE FOR THE YEAR** | | |
| - Basic (note 13(c)) | **$2.35** | $2.67 |
| - Fully diluted (note 13(c)) | **$2.35** | $2.66 |

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

# CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31st December, 2009

| | **2009** **$** | 2008 $ |
|---|---|---|
| **NET EARNINGS** | **19,648,220** | 22,171,067 |
| **OTHER COMPREHENSIVE LOSS** | | |
| Unrealized loss on assets held as available for sale | **(356,624)** | (1,194,203) |
| Unrealized foreign exchange gain (loss) on translation of foreign operations | **32,445** | (48,951) |
| **TOTAL OTHER COMPREHENSIVE LOSS** | **(324,179)** | (1,243,154) |
| **COMPREHENSIVE INCOME** | **19,324,041** | 20,927,913 |

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

# CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

For the year ended 31st December, 2009

| | **2009** **$** | 2008 $ |
|---|---|---|
| **SHARE CAPITAL** | | |
| Balance - Beginning of year | **8,327,193** | 7,477,063 |
| Shares issued under employee share purchase plan (note 13(a)) | **9,492** | 14,258 |
| Stock options exercised under equity incentive plan (note 13(b)) | **3,285** | 62,444 |
| Stock grants issued under equity incentive plan (note 13(b)) | **-** | 26,300 |
| Stock grants forfeited under equity incentive plan | **-** | (2,200) |
| Shares issued on stock dividend (note 13(d)) | **-** | 749,328 |
| Balance - End of year | **8,339,970** | 8,327,193 |
| **CONTRIBUTED SURPLUS** | | |
| Balance - Beginning of year | **1,299,466** | 911,716 |
| Stock options exercised under equity incentive plan (note 13(b)) | **110,239** | 387,750 |
| Balance - End of year | **1,409,705** | 1,299,466 |
| **SHARE PREMIUM** | | |
| Balance - Beginning of year | **56,535,475** | 41,746,781 |
| Shares issued under employee share purchase plan (note 13(a)) | **142,188** | 229,747 |
| Stock options exercised under equity incentive plan (note 13(b)) | **15,636** | 741,923 |
| Stock grants issued under equity incentive plan (note 13(b)) | **-** | 552,300 |
| Stock options forfeited under equity incentive plan | **-** | (34,800) |
| Shares issued on stock dividend (note 13(d)) | **-** | 13,299,524 |
| Balance - End of year | **56,693,299** | 56,535,475 |
| **ACCUMULATED OTHER COMPREHENSIVE (LOSS) INCOME** | | |
| Balance - Beginning of year | **(1,012,605)** | 230,549 |
| Other comprehensive loss | **(324,179)** | (1,243,154) |
| Balance - End of year | **(1,336,784)** | (1,012,605) |
| **RETAINED EARNINGS** | | |
| Balance - Beginning of year | **91,334,387** | 89,869,636 |
| Net earnings for the year | **19,648,220** | 22,171,067 |
| Cash dividends | **(6,669,065)** | (6,647,588) |
| Stock dividends | **-** | (14,058,728) |
| Balance - End of year | **104,313,542** | 91,334,387 |
| **TOTAL SHAREHOLDERS' EQUITY** | **169,419,732** | 156,483,916 |

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

# CONSOLIDATED STATEMENT OF CASH FLOWS
For the year ended 31st December, 2009

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | |
| Net earnings for the year | **19,648,220** | 22,171,067 |
| Add (deduct) items not affecting cash: | | |
| Amortization of property, plant and equipment | **2,873,724** | 2,834,901 |
| Amortization of intangible assets | **5,492,730** | 1,246,579 |
| Compensation expense related to shares and options | **450,280** | 847,818 |
| Realized loss (gain) on available for sale assets | **156,657** | 209,057 |
| Unrealized loss (gain) on held for trading assets | **3,397,969** | 2,618,678 |
| Provision for losses on investments | **(150,000)** | 250,000 |
| Non-controlling interests | **5,405,382** | 4,251,315 |
| Gain on sale of property plant & equipment | **(13,198)** | - |
| Changes in assets and liabilities: | | |
| Insurance balances receivable | **602,124** | 890,047 |
| Deferred acquisition costs | **(353,351)** | 78,893 |
| Reinsurers' share of: | | |
| Claims provisions | **(240,703)** | (3,488,375) |
| Unearned premiums | **123,686** | 997,448 |
| Accounts receivable and other | **2,441,847** | (510,191) |
| Provision for claims and adjustment expenses | **(1,146,616)** | 8,365,524 |
| Provision for future policy benefits | **5,154,181** | 3,606,772 |
| Provision for participating policy benefits | **92,836** | (105,876) |
| Claims payable | **(123,359)** | 931,230 |
| Insurance balances payable | **42,633** | (933,995) |
| Unearned premiums | **(915,493)** | (97,906) |
| Deferred commission income | **56,373** | (182,195) |
| Accounts payable and other | **814,254** | 377,210 |
| Deferred taxes | **52,074** | 102,198 |
| Income tax payable | **(40,244)** | (689,779) |
| Net cash provided by operating activities | **44,822,006** | 43,770,420 |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | |
| Purchase of investments | **(148,927,355)** | (150,377,964) |
| Proceeds from sales of investments | **129,461,133** | 127,022,760 |
| Proceeds from sales of property, plant and equipment | **13,198** | - |
| Acquisition of property, plant and equipment (note 12) | **(1,825,787)** | (1,359,575) |
| Acquisition of intangible assets (note 12) | **(1,725,298)** | (7,500,449) |
| Net cash used in investing activities | **(23,004,109)** | (32,215,228) |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | |
| Cash dividends paid | **(6,667,154)** | (6,178,515) |
| Loans repaid | **(533,834)** | (507,957) |
| Cash dividends paid to non-controlling interest | **(3,546,168)** | (2,893,847) |
| Proceeds on issue of common shares | **79,379** | 857,640 |
| Net cash used in financing activities | **(10,667,777)** | (8,722,679) |
| **INCREASE IN CASH AND SHORT-TERM DEPOSITS** | **10,150,120** | 2,832,513 |
| **CASH AND SHORT-TERM DEPOSITS - BEGINNING OF YEAR** | **48,102,581** | 45,270,068 |
| **CASH AND SHORT-TERM DEPOSITS - END OF YEAR** | **58,252,701** | 48,102,581 |

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

## CONSOLIDATED STATEMENT OF SEGREGATED FUNDS ASSETS

For the year ended 31st December, 2009

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| **CONSOLIDATED STATEMENT OF SEGREGATED FUNDS ASSETS** | | |
| Assets | | |
| Mutual funds | **329,450,143** | 260,646,381 |
| Fixed income investment and equities | **240,685,292** | 220,220,735 |
| Cash and short-term deposits | **9,328,797** | 24,255,207 |
| | **579,464,232** | 505,122,323 |
| **SEGREGATED FUNDS WITH A GUARANTEED RETURN** | **242,552,271** | 221,793,628 |
| **SEGREGATED FUNDS WITH NO GUARANTEED RETURN** | **336,911,961** | 283,328,695 |
| **SEGREGATED FUNDS NET ASSETS** | **579,464,232** | 505,122,323 |

## CONSOLIDATED STATEMENT OF CHANGES IN SEGREGATED FUNDS ASSETS

For the year ended 31st December, 2009

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| **SEGREGATED FUNDS NET ASSETS - BEGINNING OF YEAR** | **505,122,323** | 548,074,642 |
| Additions to segregated funds | | |
| Rent-a-captive premiums | **612,014** | 20,481,799 |
| Reinsurance recoveries | **90,036,029** | 2,366,667 |
| Collateral and expense funding | **800,000** | 12,500 |
| Pension contributions | **113,259,977** | 109,188,393 |
| Life insurance | **1,374,395** | 3,837,992 |
| Net realized and unrealized gains (losses) | **40,649,813** | (99,427,458) |
| Other investment income | **9,407,028** | 9,045,063 |
| | **256,139,256** | 45,504,956 |
| Deductions from segregated funds | | |
| Payments to policyholders and their beneficiaries | **(177,946,998)** | (82,579,698) |
| Management fees | **(3,744,454)** | (4,191,674) |
| Underwriting expenses | **(105,895)** | (1,685,903) |
| | **(181,797,347)** | (88,457,275) |
| Net additions (reductions) of segregated funds | **74,341,909** | (42,952,319) |
| **SEGREGATED FUNDS NET ASSETS - END OF YEAR** | **579,464,232** | 505,122,323 |

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

## 1. NATURE OF THE COMPANY AND ITS BUSINESS

BF&M Limited (the "Company") was incorporated in Bermuda on 5th August, 1991 as an investment holding company, and 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") | 51.6 | Barbados |
| Insurance Corporation of Barbados Limited/National Insurance Board Joint Venture ("ICBLJV") | 37.4 | Barbados |
| BF&M (Canada) Limited ("BF&M Canada") | 100 | Canada |

All subsidiaries have a 31st December year-end.

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

The Company'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 claims costs and management of investment funds.

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

BF&M Canada was incorporated in 2008 in Nova Scotia, Canada. The new subsidiary was established to service the Bermuda based subsidiaries, primarily in information systems development.

BF&M Investment Services Limited was formerly named North Atlantic Management Limited ("NAAM"). The name change became effective on 28th January, 2010, after filings with the Registrar of Companies and Bermuda Monetary Authority. BFMISL's objectives and licence remain otherwise unchanged.

## 2. SIGNIFICANT ACCOUNTING POLICIES

### (A) BASIS OF PRESENTATION AND CONSOLIDATION

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Bermuda and Canada. These consolidated financial statements include the accounts of the Company, along with full consolidation of all of the Company's subsidiaries, and are stated in Bermuda dollars. Interest related to minority shareholders is accounted for as non-controlling interest. All significant transactions and balances between these subsidiaries have been eliminated on consolidation.

### (B) USE OF ESTIMATES

The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements. Estimates also affect the reported amounts of income and expenses for the reporting period. Actual results could differ from those estimates.

### (C) FINANCIAL INSTRUMENTS

**Bonds**

Bonds are included within investments on the Consolidated Balance Sheet. Bonds that are traded on an active market are designated as held for trading and are carried at fair value. Realized and unrealized gains and losses on held for trading bonds are recorded to changes in fair value of held for trading assets within investment income in the Consolidated Statement of Earnings. Investment in bonds where a market value cannot reasonably be determined are classified as loans and receivables and carried at amortized cost. Purchases and sales of bonds are recognized on their trade dates, the date that the Company commits to purchase or sell the bond. Transactions costs are expensed immediately. Interest income earned on bonds is recorded within investment income in the Consolidated Statement of Earnings.

**Equities**

Equities are included within investments on the Consolidated Balance Sheet. They are designated as either held for trading or available for sale based on management's intention and are carried at fair value. Realized and unrealized gains and losses on held for trading equities are recorded to changes in fair value of held for trading assets within investment income in the Consolidated Statement of Earnings. Unrealized gains and losses on available for sale equities are recorded in other comprehensive income until the asset is sold or otherwise disposed of at which point the realized gain or loss is recorded to investment income in the Consolidated Statement of Earnings. Purchases and sales of equities are recognized on their trade dates, the date that the Company commits to purchase or sell the equity. Transaction costs are expensed immediately. Dividends earned on equities are recorded within investment income on the Consolidated Statement of Earnings.

**Mortgage and loans**

Mortgage and loans are included within investments on the Consolidated Balance Sheet. They are carried at amortized cost and are recognized on their trade dates. Transaction costs are expensed immediately. Interest income earned is recorded within investment income on the Consolidated Statement of Earnings.

**Fair Value Measurement**

Fair values for bonds classified as held for trading or available for sale are determined using quoted market bid prices provided by third party independent pricing sources. Where prices are not quoted in a normally active market, fair values are determined by valuation models. When available, quoted prices for identical assets at the balance sheet date are used to measure bonds at fair value in held for trading and available for sale portfolios.

The Company estimates the fair value of bonds not traded in active markets by referring to actively-traded securities with similar attributes, dealer quotations, matrix pricing methodology, discounted cash flow analyses or pricing valuation models.

Market values for bonds and mortgages and loans classified as loans and receivables are determined by discounting expected future cash flows using current market rates.

Fair value for publicly traded equities are generally determined by the closing bid price for the security from the exchange where it is principally traded. Fair values for equities for which there is no active market are determined at the last bid price.

**Disclosures**

Effective January 1, 2009, the Company adopted the amended CICA Handbook Section 3862, Financial Instruments - Disclosures. Disclosure standards have been expanded to be consistent with new disclosure requirements made under International Financial Reporting Standards (IFRS) that classify financial instruments measured at fair value at one of three levels according to the relative reliability of the inputs used to estimate the fair values. Any instrument within the scope of the Section that has been measured at fair value on the balance sheet must be included within the hierarchy, including all instruments classified as "held-for-trading" or "available-for-sale".

**Impairment**

The carrying amount of the Company's financial instruments is reviewed for impairment at each balance sheet date. Since held for trading bonds and equities are recorded at fair value with changes in fair value recorded to income, any reduction in value of these assets due to impairment is already reflected in investment income. When it is determined that an available for sale equity is impaired and the decline is other than temporary, the loss accumulated in Other Comprehensive Income (OCI) is reclassified to net gains (losses) on available for sale assets within investment income. Mortgages and loans and bonds classified as loans and receivables are impaired when there is no longer assurance of the timely collection, either through an agreed payment schedule or receipt of proceeds on sale of security, of the full amount of principal and interest. When these assets are impaired an allowance is established to adjust the carrying value of the assets to its net recoverable amount. Interest would no longer be accrued and previous interest accruals would be reversed. Allowances and reversals would be charged against net investment income.

### (D) SEGREGATED FUNDS

Segregated funds are lines of business in which the Company issues a contract where the benefit amount is directly linked to either the market value of the investments held in the particular segregated funds, or a guaranteed return on assets held in the particular segregated funds. The underlying assets are registered in the name of the Company and the segregated fund contract holder has no direct access to the specific assets. The contractual arrangements are such that the segregated fund contract holder bears the risks and rewards of the account's investment performance, except for segregated funds with a guaranteed return where the risks for these accounts are borne by the Company.

Segregated fund assets are carried at fair value as shown on the Consolidated Statement of Segregated Funds Net Assets. Fair values are determined using quoted market values. Segregated fund assets may not be applied against liabilities that arise from any other business of the Company. The investment results of the segregated funds are reflected directly in segregated fund liabilities, except for segregated funds with a guaranteed return where the excess or deficiency of the return on the assets over the guaranteed return is reflected in investment income in the Consolidated Statement of Earnings. For the segregated funds where the benefit amount is directly linked to the market value of the investments, the Company derives only fee income which is included within commissions and other income on the Consolidated Statement of Earnings.

Assets and liabilities for rent-a-captive segregated accounts relate to certain funding contracts, which are arranged by the Company 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 available only to settle the corresponding segregated account liabilities and accordingly are included within segregated funds with no guaranteed return on the Consolidated Balance Sheet.

### (E) CASH AND SHORT-TERM DEPOSITS

Cash and short-term deposits include cash and time deposits with an ordinary maturity of ninety days or less from date of purchase. The carrying value of cash and short-term deposits approximates their fair value.

### (F) REVENUE RECOGNITION

#### (i) Premium income

For property and casualty insurance products, premiums written are earned on a pro-rata basis over the terms of the policies to which they relate. Unearned premiums represent the portion of premiums written that relate to periods of risk subsequent to the year-end. The reinsurers' share of unearned premium, net of any provision for doubtful accounts, is recognized as an asset at the same time and using principles consistent with the Company's method for determining the unearned premium liability.

Premiums written from life and health policies are recognized as revenue when due from policyholders.

Premiums receivable are recorded at amounts due less any required provision for doubtful accounts.

### (ii) Commission and other income

Commission income is recognized over the term of the related reinsurance policies and in accordance with the expensing of the related reinsurance premiums. The recognition of profit commissions is also dependent on the loss experience underlying such reinsurance policies.

Other income is recognized when earned, collectible and the amount can be reasonably estimated. Other income primarily includes fees earned from the management of segregated fund assets, pension administrative services, and investment advisement and management.

### (iii) Rental Income

Rental income is recorded on an accrual basis.

## (G) POLICY ACQUISITION COSTS

Policy acquisition costs are those expenses incurred in the acquisition of business. Acquisition costs are comprised of commissions. These costs are expensed in accordance with the earning of the related premium. Deferred policy acquisition costs are included within assets on the balance sheet.

Policy acquisition costs related to unearned premiums are only deferred to the extent that they can be expected to be recovered from the unearned premiums, and are amortized to income over the periods in which the premiums are earned. If the unearned premiums are not sufficient to pay expected claims and expenses, a premium deficiency is said to exist. Anticipated investment income can be considered in determining whether a premium deficiency exists. Premium deficiencies are recognized by writing down the deferred policy acquisition cost asset.

## (H) REINSURANCE

For general insurance, reinsurance is recorded on a gross basis as it pertains to reinsurance recoveries and unearned premiums on the balance sheet and premiums ceded in the statement of earnings, to indicate the extent of credit risk related to reinsurance. Reinsurance is recorded on a net basis as it pertains to claims, benefits and claims expenses in the statement of earnings to indicate the results of its retention of losses.

For life insurance, the provision for the future policy benefits and policy benefits are recorded on a net basis.

## (I) LOANS TO POLICYHOLDERS

Loans to policyholders are carried at their unpaid balance and are fully secured by the policy values on which the loans are made. Carrying value of loans to policyholders approximates their fair values.

## (J) PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are carried at cost less accumulated amortization. Amortization is recorded on a straight-line basis over their estimated useful lives at the following rates:

| | |
|---|---|
| Buildings | 2% |
| Furniture, equipment and leasehold improvements | 10% - 20% |
| Computer hardware and software | 20% - 33% |
| Investment properties and leasehold improvements | 2% - 20% |

## (K) GOODWILL AND INTANGIBLE ASSETS

Goodwill represents the excess of the cost of ICBL at acquisition over the fair value of the net assets acquired. Intangible assets are allocated between indefinite and finite life intangible assets. Finite life assets are amortized on a straight-line basis over their estimated useful lives. Goodwill and intangible assets with indefinite lives are not amortized but 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 estimated fair value.

### (L) PROVISION FOR CLAIMS AND ADJUSTMENT EXPENSES AND FUTURE POLICY BENEFITS

**(i) Provision for claims and adjustment expenses**

Provision 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 Company's underwriting year development experience. The provision is determined using generally accepted actuarial practices in Canada. 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, net of any required provision for doubtful amounts, are estimated using principles consistent with the Company's method for establishing the related liability and are recorded in accordance with the terms of the Company's reinsurance agreements.

**(ii) Provision for future policy benefits**

The provision for future policy benefits 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.

The policy actuarial liability reserves are determined using generally accepted actuarial practices according to standards established by the Canadian Institute of Actuaries ("CIA"). In accordance with these standards, the policy actuarial liability reserves have been determined using the Canadian Asset Liability Method ("CALM") and the Standards of Practice for the Valuation of Policy Liabilities of Life Insurers ("LSOP").

The policy actuarial liability reserves 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. The policy actuarial liability reserves make sufficient provision for the expected experience scenario and for adverse deviations in experience. Many of the estimates used in actuarial valuation relate to future events and involve a significant amount of judgement. As a result these estimates are subject to revision at subsequent measurement dates.

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

### (M) POLICYHOLDER DIVIDENDS

Policyholder dividends are charged to the operations of the participating line of business on an annual basis. Dividends vary depending on the type and duration of the policy and the age of the insured at the date of issue.

### (N) FOREIGN CURRENCY TRANSLATION

The Company follows the current rate method of foreign currency translation for its net investment in its self-sustaining foreign operations. Under this method, assets and liabilities are translated to Bermudian dollars at the rate of exchange prevailing at the balance sheet dates and all income and expense items are translated at an average of daily rates. Any unrealized foreign currency translation gains and losses would be presented separately as a component of other comprehensive income.

The exchange rate between Barbadian and Bermudian dollars has essentially remained unchanged since the acquisition of the Barbadian self-sustaining foreign operation in 2005 and as a result there are no unrealized translation gains and losses to be reported.

Foreign currency translation gains and losses included as a component of Other Comprehensive Income relate to the consolidation of BF&M Canada.

### (O) PENSION PLANS AND OTHER POST-RETIREMENT BENEFITS

The Company's projected pension benefit obligation is discounted using a market interest rate based on high quality debt instruments. For the purpose of calculating the expected return on plan assets, those assets are fair valued. 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 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.

In addition to pension benefits, the Company provides post-retirement benefits for health care. These costs are recognized on an accrual basis during the years when service is provided to the Company. 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.

### (P) SHARE BASED COMPENSATION PLANS

The Company has an Equity Incentive Plan which is described in note 13(b). Share 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 three year vesting period as compensation expense within earnings.

This plan also includes share options which are issued with an exercise price set at the fair market value of the Company's shares at the date of issuance. The Company determines the fair value of the options on the date of grant using an option pricing model. The amount of the benefit of these options is also amortized over the three year vesting period as compensation expense within earnings. Effective 2009, options will not longer be issued.

### (Q) INCOME TAX

Income tax for the year, on the Company's Barbados and Canadian operations, comprises current and deferred tax. Income tax is recognized in the Consolidated Statement of Earnings except to the extent that it relates to items recognized directly to equity, in which case it is recognized into equity.

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred income tax is provided using the liability method, which requires the recognition of deferred tax liabilities and assets for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of other assets and liabilities. Deferred income tax assets are only recognized to the extent that it is probable that future taxable profit will be available, against which the temporary differences can be utilized.

## 3. ACCOUNTING POLICY DEVELOPMENTS

### (A) CHANGES IN ACCOUNTING POLICIES

#### (i) Capital Disclosures

Effective 1st January, 2008, the Company adopted Canadian Institute of Chartered Accountants ("CICA") Handbook Section 1535, Capital Disclosures. The section establishes standards for disclosing information that enables users of financial statements to evaluate the entity's objectives, policies and processes for managing capital; information about what the entity requires as capital; whether the entity has complied with any capital requirements; and the consequences of not complying with these capital requirements. The new requirements are for disclosure only and did not impact the financial results of the Company. This new disclosure is included in note 5 of these Consolidated Financial Statements.

**(ii) Financial Instrument Disclosure and Presentation**

Effective 1st January, 2008, the Company adopted CICA Handbook Section 3862, Financial instruments - Disclosures, and Section 3863, Financial Instruments - Presentation. These sections replaced Section 3861, Financial Instruments Disclosure and Presentation. Presentation standards are carried forward from Section 3861 and remain unchanged. Disclosure standards are enhanced and expanded and focus on disclosures related to the nature and extent of risks arising from financial instruments and how the Company manages those risks. The new requirements are for disclosure only and did not impact the financial results of the Company. This new disclosure is included in note 5 of these Consolidated Financial Statements.

Effective 1st January, 2009, the Company adopted the amended CICA Handbook Section 3862, Financial Instruments - Disclosures. Disclosure standards have been expanded to be consistent with new disclosure requirements made under International Financial Reporting Standards (IFRS) that classify financial instruments measured at fair value at one of three levels according to the relative reliability of the inputs used to estimate the fair values. Any instrument within the scope of the Section that has been measured at fair value on the balance sheet must be included within the hierarchy, including all instruments classified as "held-for-trading" or "available-for-sale". This new disclosure is included in note 4 of these Consolidated Financial Statements.

**(iii) Goodwill and Intangible Assets**

Effective 1st January, 2009, the Company adopted CICA Handbook Section 3064, Goodwill and Intangible Assets. This section replaces Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. This section established standards for the recognition, measurement, presentation and disclosure of goodwill and intangible assets. Provisions concerning goodwill are unchanged from the previous Section 3062. The provisions relating to intangible assets, including internally generated intangible assets, are incorporated from International Financial Reporting Standards. The effect is to transfer internally developed software costs from property, plant & equipment to intangible assets subject to amortization. This information is set out in Note 12 - Intangible Assets.

**(B) FUTURE ACCOUNTING AND REPORTING CHANGES**

**(i) Convergence with International Financial Reporting Standards**

In February 2008, the CICA announced that Canadian generally accepted accounting principles for publicly accountable enterprises will be replaced by International Financial Reporting Standards ("IFRS") for fiscal years beginning on or after 1st January, 2011. The Company will be required to report using IFRS standards for its interim and annual financial statements beginning 1st January, 2011.

The Company developed an IFRS changeover plan which addresses key areas such as accounting policies, financial reporting, disclosure controls and procedures, information systems, education and training, and other business activities. The Company, as part of its changeover plan, has identified differences in accounting policies and with respect to certain choices upon conversion in accordance with IFRS 1, First-time Adoption of IFRS.

The Company will continue to assess the impact of adopting IFRS and will update its interim and annual disclosures to report on the progress of its changeover plan. It is possible that the changeover to IFRS could have a material impact on the presentation of the Company's consolidated financial statements, though we do not anticipate any material changes to shareholders' equity or retained earnings.

## 4. INVESTMENTS AND RELATED INVESTMENT INCOME

### (A) CARRYING VALUE AND FAIR VALUE OF INVESTMENTS

Investments comprise:

| | **2009** | | 2008 | |
|---|---|---|---|---|
| | **Carrying value $** | **Fair value $** | Carrying value $ | Fair value $ |
| Bonds | | | | |
| Held for trading | **93,795,955** | **93,795,955** | 89,367,778 | 89,367,778 |
| Loans and receivables | **65,699,607** | **68,688,641** | 61,471,097 | 61,454,875 |
| Equities | | | | |
| Held for trading | **11,143,126** | **11,143,126** | 11,817,433 | 11,817,433 |
| Available for sale | **5,426,657** | **5,426,657** | 5,040,201 | 5,040,201 |
| Mortgages and loans | | | | |
| Loans and receivables | **88,283,698** | **88,266,622** | 81,262,673 | 81,358,357 |
| | **264,349,043** | **267,321,001** | 248,959,182 | 249,038,644 |

Included in the investments balance of $264,349,043 (2008 - $248,959,182) is $41,584,456 (2008 - $43,914,611) which has been pledged to meet the requirements of Section 25(5) of the Barbados Insurance Act 1996-32 and $499,376 (2008 - $499,376) of investments which is being held by the Supervisor of Insurance of Barbados as required under Section 23(2)(b) of the Barbados Insurance Act.

During 2009, CICA Handbook Section 3862, Financial Instruments - Disclosures ("Section 3862"), was amended to require disclosures about the inputs to fair value measurements, including their classification within a hierarchy that prioritizes the inputs to fair value measurement. 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 Company's financial instruments within the fair value hierarchy as at 31st December, 2009:

| | **Level 1 $** | **Level 2 $** | **Level 3 $** | **Total $** |
|---|---|---|---|---|
| Bonds | - | 93,795,955 | - | 93,795,955 |
| Equities | 9,257,066 | 7,312,717 | - | 16,569,783 |
| | 9,257,066 | 101,108,672 | - | 110,365,738 |

The following table illustrates the classification of the Company's segregated funds' financial instruments within the fair value hierarchy as at 31st December, 2009:

| | **Level 1 $** | **Level 2 $** | **Level 3 $** | **Total $** |
|---|---|---|---|---|
| Segregated Funds | 133,034,780 | 405,948,452 | - | 538,983,232 |
| | 133,034,780 | 405,948,452 | - | 538,983,232 |

### (B) MORTGAGES AND LOANS

Mortgages and loans comprise:

| | 2009 $ | 2008 $ |
|---|---|---|
| Mortgages | **85,514,152** | 79,417,738 |
| Loans | **2,769,546** | 1,844,936 |
| Total | **88,283,698** | 81,262,674 |

### (C) INVESTMENT INCOME

| | 2009 $ | 2008 $ |
|---|---|---|
| Investment Income | | |
| Bonds - held for trading | **6,261,783** | 6,594,157 |
| Bonds - loans and receivables | **2,876,254** | 2,302,350 |
| Equities - held for trading | **374,724** | 518,683 |
| Equities - available for sale | **195,147** | 193,390 |
| Mortgages and loans - loans and receivables | **5,921,530** | 6,416,025 |
| Bank deposits and policyholder loans | **1,285,263** | 1,516,524 |
| Net realized losses on available for sale assets | **(156,657)** | (209,057) |
| Change in fair value of held for trading assets | | |
| Bonds | **(712,724)** | 2,366,153 |
| Equities | **(2,685,245)** | (4,984,831) |
| | **13,360,075** | 14,713,394 |

## 5. MANAGEMENT OF FINANCIAL RISK INCLUDING CAPITAL MANAGEMENT

### (A) 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 Company. 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 only the purchase of investment-grade assets and minimize undue concentration of assets in any single company, asset class or credit rating.
- Investment guidelines specify collateral requirements for mortgages and loans which include the property described in note 4(b).
- Maintaining a strong underwriting strategy and related guidelines.
- Transacting business with well established reinsurance companies with strong credit ratings. All major reinsurers are rated A- or better with A.M. Best.

#### (i) Maximum exposure to credit risk

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

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Cash and short-term deposits | **58,252,701** | 48,102,581 |
| Bonds | **159,495,562** | 150,838,875 |
| Mortgages and loans | **88,283,698** | 81,262,673 |
| Insurance balances receivable | **29,871,393** | 30,473,517 |
| Accounts receivable | **22,954,677** | 25,396,524 |
| | **358,858,031** | 336,074,170 |

#### (ii) 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 characteristics are similar in that changes in economic or political environments may impact their ability to meet obligations as they come due.

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

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Bonds issued or guaranteed by: | | |
| Financials | **49,619,958** | 56,854,058 |
| Federal government | **56,594,557** | 43,497,464 |
| U.S. Treasury and other agencies | **24,030,861** | 25,086,585 |
| Utilities and energy | **10,250,655** | 8,922,522 |
| Consumer staples and discretionary | **8,403,289** | 4,070,663 |
| Telecom | **4,412,472** | 3,490,478 |
| Computer technology products and services | **2,385,249** | 2,520,654 |
| Other | **3,798,521** | 6,396,451 |
| Total bonds | **159,495,562** | 150,838,875 |

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| United States | **81,046,669** | 78,954,766 |
| Barbados | **63,485,080** | 58,873,419 |
| Canada | **5,903,537** | 5,135,952 |
| Caribbean | **2,058,386** | 2,197,447 |
| Germany | **698,977** | 1,628,207 |
| United Kingdom | **1,320,041** | 1,419,734 |
| Other | **4,982,872** | 2,629,350 |
| Total bonds | **159,495,562** | 150,838,875 |

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

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Bermuda | **82,837,269** | 77,001,328 |
| Barbados | **5,446,429** | 4,261,345 |
| Total mortgages and loans | **88,283,698** | 81,262,673 |

The carrying value of premiums receivable by geographic location is shown in the following table:

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Bermuda | **14,006,616** | 14,787,887 |
| Barbados | **7,949,485** | 6,651,600 |
| Total premiums receivable | **21,956,101** | 21,439,487 |

**(iii) Credit quality of financial assets**

Bond Portfolio Quality

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| AAA | **35,578,015** | 34,525,578 |
| AA | **16,566,713** | 16,854,712 |
| A | **43,524,750** | 79,467,271 |
| BAA | **-** | 328,444 |
| BBB | **52,058,228** | 2,795,023 |
| BB and lower | **-** | 88,934 |
| Not rated* | **11,767,856** | 16,778,913 |
| Total bonds | **159,495,562** | 150,838,875 |

* Not rated bonds relate to assets held within ICBL's investment portfolio that are not traded in an active market.

**(iv) Mortgages and loans credit risk**

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 values of the loans past due but not impaired:

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Not past due | **69,125,634** | 38,392,610 |
| Past due but not impaired: | | |
| Past due less than 90 days | **9,694,465** | 20,258,685 |
| Past due 90 to 180 days | **2,467,803** | 7,165,957 |
| Past due 180 days or more | **6,243,716** | 15,274,492 |
| Impaired (net of impairment provisions of 2009 - $100,000, 2008 - $250,000) | **752,080** | 170,929 |
| Total mortgages and loans | **88,283,698** | 81,262,673 |

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. The corporate loans are secured by a certificate of annual repayment of principal and interest by the Barbados National Bank.

### (B) LIQUIDITY RISK

Liquidity risk is the risk that the Company may not be able to meet its 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 Company's short-term obligations. The Company also closely manages operating liquidity through cash flow matching of assets and liabilities on its life and health insurance 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 with specific maturities at 31st December, 2009 was as follows:

| | **Within 1 year** $ | **2 to 3 years** $ | **4 to 5 years** $ | **Over 5 years** $ | **Total** $ | **Effective interest rate ranges** |
|---|---|---|---|---|---|---|
| Bonds | **41,696,962** | **32,044,123** | **32,668,960** | **53,085,517** | **159,495,562** | **1.1% - 9.1%** |
| Mortgages | **56,997** | **464,773** | **1,555,004** | **83,437,378** | **85,514,152** | **6.5% - 9.0%** |
| Corporate loans | **-** | **2,769,546** | **-** | **-** | **2,769,546** | **6.0% - 9.7%** |
| | **41,753,959** | **35,278,442** | **34,223,964** | **136,522,895** | **247,779,260** | |
| **PERCENT OF TOTAL** | **17%** | **14%** | **14%** | **55%** | **100%** | |

The maturity profile of investments with specific maturities at 31st December, 2008 was as follows:

| | Within 1 year $ | 2 to 3 years $ | 4 to 5 years $ | Over 5 years $ | Total $ | Effective interest rate ranges |
|---|---|---|---|---|---|---|
| Bonds | 23,840,396 | 36,261,393 | 39,853,490 | 50,883,596 | 150,838,875 | .36% - 9.5% |
| Mortgages | 4,812,824 | 7,573,705 | 7,844,078 | 59,187,131 | 79,417,738 | 6.0% - 9.0% |
| Corporate loans | - | 1,844,936 | - | - | 1,844,936 | 6.0% - 9.7% |
| | 28,653,220 | 45,680,034 | 47,697,568 | 110,070,727 | 232,101,549 | |
| **PERCENT OF TOTAL** | 12% | 20% | 21% | 47% | 100% | |

The maturity profiles of the Company'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 with specific maturities at 31st December, 2009 is as follows:

| | **Within 1 year** $ | **2 to 3 years** $ | **4 to 5 years** $ | **Over 5 years** $ | **Total** $ |
|---|---|---|---|---|---|
| Claims payable | **2,595,062** | **-** | **-** | **-** | **2,595,062** |
| Insurance balances payable | **6,637,200** | **-** | **-** | **-** | **6,637,200** |
| Accounts payable and other | **31,541,993** | **-** | **-** | **-** | **31,541,993** |
| Loans payable | **620,412** | **1,307,433** | **1,398,483** | **1,673,400** | **4,999,728** |
| | **41,394,667** | **1,307,433** | **1,398,483** | **1,673,400** | **45,773,983** |

The maturity profile of liabilities with specific maturities at 31st December, 2008 was as follows:

| | Within 1 year $ | 2 to 3 years $ | 4 to 5 years $ | Over 5 years $ | Total $ |
|---|---|---|---|---|---|
| Claims payable | 2,718,421 | - | - | - | 2,718,421 |
| Insurance balances payable | 6,594,567 | - | - | - | 6,594,567 |
| Accounts payable and other | 30,799,537 | - | - | - | 30,799,537 |
| Loans payable | 595,051 | 1,387,712 | 1,474,507 | 2,076,292 | 5,533,562 |
| | 40,707,576 | 1,387,712 | 1,474,507 | 2,076,292 | 45,646,087 |

### (C) 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.

#### (i) 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 Company is not significantly exposed to foreign exchange risk because of the following:

- The majority of the Company'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 essentially remained unchanged since the acquisition of the Barbadian entity.
- The Company's Canadian operation is fully integrated. Its assets and liabilities are not considered material.

#### (ii) Interest rate risk

Interest rate risk is the potential for financial loss arising from changes in 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 Company 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.
- Quantifying and reviewing regularly the risk associated with the mismatch in portfolio duration and cash flow.

The impact of interest rate risk for the Company's actuarial liabilities and the assets supporting those liabilities is included in Note 8(c).

#### (iii) Equity risk

Equity risk is the uncertainly associated with the valuation of assets arising from changes in equity markets. To mitigate price risk, the Company has investment policy guidelines in place that provide for prudent investment in equity markets within clearly defined limits.

Equities generally do not support actuarial liabilities. Changes in fair value of held for trading equities are recorded to the Consolidated Statement of Earnings. For the Company's held for trading equities, an immediate 10% increase or decrease in stock prices at 31st December would result in an increase or decrease to net earnings of $1,114,313. Changes in fair value of available for sale assets are recorded to OCI. A 10% increase or decrease in stock prices at 31st December would result in an increase or decrease to OCI of $542,666.

#### (D) CAPITAL MANAGEMENT

The Company's policy is to maintain a strong consolidated capital base. The Company manages its capital to ensure its continued ability to provide an adequate return to shareholders, provide flexibility to take advantage of growth opportunities, maintain a strong credit rating, and to support the risks associated with the business of the Company.

The Company's capital base consists of share capital, contributed surplus, share premium, accumulated other comprehensive income, and retained earnings as disclosed within Shareholders' equity on the Consolidated Balance Sheet.

Management monitors the adequacy of the Company and its operating subsidiaries' capital from the perspective of both the Bermuda and Barbados Insurance Act and Companies Act. The Company'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 Canada known as the Minimum Continuing Capital and Surplus Requirements. Furthermore, the Company'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 Company's capital. In order to maintain or adjust the capital structure, the Company may adjust the amount of dividends paid to shareholders or issue new shares.

The Company maintained capital levels above the minimum local regulatory requirements as at both 31st December 2009 and 2008. Restrictions on distributions from capital are detailed in Note 19.

## (6) PROPERTY PLANT AND EQUIPMENT

Property, plant and equipment comprise:

| | | | **2009** | 2008 |
|---|---|---|---|---|
| | Cost<br>$ | Accumulated amortization<br>$ | **Net**<br>**$** | Net<br>$ |
| Land and buildings | 13,630,659 | 2,097,017 | **11,533,642** | 11,714,418 |
| Furniture, equipment and leasehold improvements | 7,483,738 | 5,166,634 | **2,317,104** | 2,978,362 |
| Computer hardware and software | 6,381,889 | 4,823,870 | **1,558,019** | 1,055,332 |
| Investment properties | 49,831,290 | 10,266,843 | **39,564,447** | 40,259,839 |
| | 77,327,576 | 22,354,364 | **54,973,212** | 56,007,951 |

Investment properties consist of the 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, see note 9. Additional investment properties include land being used for car parking facilities and two buildings being used for rental. These properties are owned by a 51.6% owned subsidiary.

At 31st December, 2009, land and buildings and investment properties with a net book value of $51,098,089 (2008 - $51,974,257) were estimated to be valued at $96,567,241 (2008 - $97,089,888) 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 2007 for the Bermuda based properties, and ICBL's headquarters, and 2009 for the Barbados based investment properties.

## (7) PROVISION FOR CLAIMS AND ADJUSTMENT EXPENSES

The reconciliation of provision for claims and adjustment expenses for the years ended 31st December, 2009 and 2008 is as follows:

| | **2009** | 2008 |
|---|---|---|
| Net provision for claims and adjustment expenses at beginning of year | **50,113,613** | 45,236,464 |
| Reinsurers' share of provision for claim and adjustment expenses | **17,894,725** | 14,406,351 |
| Gross provision for claims and adjustment expenses at beginning of year | **68,008,338** | 59,642,815 |
| Gross claims and adjustment expenses in respect of incurred losses | **24,515,742** | 27,718,449 |
| Gross claims and adjustment expenses in respect of paid losses | **25,662,358** | 19,352,925 |
| Net provision for claims and adjustment expenses at end of year | **48,726,295** | 50,113,614 |
| Reinsurers' share of provision for claim and adjustment expenses | **18,135,428** | 17,894,725 |
| Gross provision for claims and adjustment expenses at end of year | **66,861,723** | 68,008,339 |

The fair value of the net provision for claims and adjustment expenses of $48,726,295 is $43,678,900 (2008 - $50,113,614 is $45,514,600). The fair value is calculated by the Company's actuary and represents the discounted value of the net provision.

ICBL records its claim reserves on a discounted basis. The Company records the reserves on an undiscounted basis. The difference between the claims reserves on an undiscounted basis and discounted basis on the date of acquisition of ICBL by BF&M was approximately; $5,000,000. BF&M will amortize $1,000,000 through earnings to reflect this difference in each of years 2006 through 2010 inclusive.

### (A) ASSUMPTIONS

Uncertainty exists on reported claims in that all information may not be available at the reporting date therefore, the claim cost may rise or fall at some date in the future when the information is obtained. In addition, claims may not be reported to the Company immediately; therefore, estimates are made as to the value of claims incurred but not yet reported, a value which may take some months or years to finally determine. The provision is based on an actuarial analysis of the Company's underwriting year development experience. The provision is determined using generally accepted actuarial practices.

### (B) REINSURANCE RECOVERIES

The Company has guidelines and a review process in place to ascertain the creditworthiness of the companies to which it cedes. In 2009 and 2008 the Company had no write-offs. No information has come to the Company's attention indicating weakness or failure of any of its current reinsurers, therefore no provision has been made in the accounts for doubtful collection.

While reinsurance arrangements provide for the recovery of claims arising from the liabilities ceded, the Company retains primary responsibility to the policyholders.

## 8. PROVISION FOR FUTURE POLICY BENEFITS

### (A) COMPOSITION OF ACTUARIAL LIABILITIES AND RELATED SUPPORTING ASSETS

**(i)** The composition of the actuarial liabilities is as follows:

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Participating | | |
| Individual life | **27,565,424** | 27,937,420 |
| Non-participating | | |
| Individual life | **7,795,641** | 7,718,071 |
| Universal life | **5,235,539** | 8,415,420 |
| Annuities | **55,466,294** | 48,828,847 |
| Group life | **7,354,992** | 6,088,071 |
| Health and accident | **17,401,440** | 16,677,320 |
| | **120,819,330** | 115,665,149 |

**(ii)** The composition of the assets supporting liabilities is as follows:

| | **2009** | | | |
|---|---|---|---|---|
| | **Bonds** | **Mortgages and loans** | **Cash** | **Total** |
| | **$** | **$** | **$** | **$** |
| Participating | | | | |
| Individual life | **23,528,543** | **2,122,619** | **1,914,262** | **27,565,424** |
| Non-participating | | | | |
| Individual life | **6,327,655** | **1,467,986** | **-** | **7,795,641** |
| Universal life | **5,235,539** | **-** | **-** | **5,235,539** |
| Annuities | **29,926,147** | **24,394,599** | **1,145,548** | **55,466,294** |
| Group life | **1,560,586** | **5,794,406** | **-** | **7,354,992** |
| Health and accident | **17,401,440** | **-** | **-** | **17,401,440** |
| | **83,979,910** | **33,779,610** | **3,059,810** | **120,819,330** |

| | 2008 | | | |
|---|---|---|---|---|
| | Bonds $ | Mortgages and loans $ | Cash $ | Total $ |
| Participating | | | | |
| Individual life | 26,716,817 | - | 1,220,603 | 27,937,420 |
| Non-participating | | | | |
| Individual life | 6,334,409 | 1,383,662 | - | 7,718,071 |
| Universal life | 8,415,420 | - | - | 8,415,420 |
| Annuities | 39,838,548 | 7,298,141 | 1,692,158 | 48,828,847 |
| Group life | 1,346,758 | 4,741,313 | - | 6,088,071 |
| Health and accident | 16,677,320 | - | - | 16,677,320 |
| | 99,329,272 | 13,423,116 | 2,912,761 | 115,665,149 |

### (B) CHANGES IN ACTURIAL LIBILITIES

The changes in the actuarial liabilities for insurance and annuity benefits are as follows:

| | **2009** **$** | 2008 $ |
|---|---|---|
| Balance - beginning of year | **115,665,149** | 112,058,377 |
| Normal changes | **4,683,823** | 6,041,427 |
| Interest rate assumption | **4,207,831** | (366,724) |
| Mortality assumption | **(374,890)** | (104,695) |
| Changes in other actuarial assumptions | **(3,115,697)** | (488,580) |
| Transfer (to) segregated accounts | **-** | (1,260,400) |
| Other changes | **(246,886)** | (214,256) |
| **BALANCE - END OF YEAR** | **120,819,330** | 115,665,149 |

### (C) ACTUARIAL ASSUMPTIONS AND MEASUREMENT UNCERTAINTY

**Mortality**

Mortality refers to the rates at which death occurs for defined groups of people. The Company's portfolio of business is too small to form the basis for any company produced mortality table. The Company's mortality assumption is based on industry experience. The assumed mortality rates for life insurance contracts do not reflect any future expected improvement. On annuities, where lower mortality rates result in an increase in liabilities, assumed future mortality rates are adjusted to reflect estimated future improvements in the rates.

For life products where higher mortality would be financially adverse to the Company, a 1% increase in the best estimate assumption would increase the actuarial liabilities by $106,000. For annuity products where lower mortality would be financially adverse to the Company, a 1% decrease in the best estimate assumption would increase the actuarial liabilities by $157,000.

**Morbidity**

Morbidity refers to both the rates of accident or sickness and the rates of recovery therefrom. The Company's long term disability and medical expense insurance is marketed mostly on a group basis. The most significant morbidity risk relates to the group and individual medical business. A 1% increase in medical claims net of reinsurance would increase the actuarial liabilities by $699,000.

### Investment returns

Assets are segmented to correspond to the different liability categories of the Company. For each segment, the projected current asset and liability cash flows are used in 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 Company 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 $761,640.

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 $512,046.

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, actuarial calculations, 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. A 10% increase in the best estimate maintenance unit expense assumption would increase the actuarial liabilities by approximately $934,000.

### Policy termination

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 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 $593,000.

### 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.

## (D) RISK MANAGEMENT

### Interest rate risk

Interest rate risk is the potential for financial loss arising from changes in interest rates. The Company is exposed to this risk when cash flows from assets that support the liabilities are significantly mismatched, resulting in the need to either sell assets to meet policyholder obligations and expenses or to reinvest excess asset cash flows under unfavourable interest rate environments.

To manage this risk, an investment policy statement was established to match portfolio investments with insurance liability cash flows that are reasonably predictable under a cash-matched program. A separate investment policy statement was established to manage the remaining liabilities and surplus of the Company based upon a total return approach. No derivative instruments are permitted under either investment policy.

**Credit risk**
Credit risk is managed through an emphasis on the asset quality, mix and single issuer exposure of the asset portfolio.

Projected investment returns are reduced to provide for future credit losses on assets. The net effective yield rate reduction averaged 0.50% (0.54% in 2008). The calculation for future credit losses on assets is based on the credit quality of the underlying asset portfolio.

The following outlines the future credit losses on assets provided for in the actuarial liabilities. These amounts are in addition to the allowance for asset losses included within the assets:

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Participating | **136,000** | 146,000 |
| Non-participating | **1,240,000** | 1,160,000 |
| | **1,376,000** | 1,306,000 |

**Reinsurance risk**
Maximum benefit amount limits per insured life, which vary by line of business, are established for life and health insurance and reinsurance is purchased for amounts in excess of those limits.

Reinsurance contracts do not relieve the Company from its obligations to policyholders. Failure of reinsurers to honour their obligations could result in losses to the Company.

As a result of reinsurance, the actuarial liabilities have been increased by the following amounts:

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Participating | **916,000** | 812,000 |
| Non-participating | **161,000** | 6,000 |
| | **1,077,000** | 818,000 |

**Liquidity risk**
Liquidity risk is the risk that the Company will have difficulty raising funds in order to meet commitments. The liquidity needs of the Company are managed through cash flow matching of assets and liabilities and forecasting earned and required yields to ensure consistency between policyholder requirements and the yield of assets purchased. Approximately 62% of policy liabilities are non-cashable prior to maturity or are subject to market value adjustments.

**(E) FAIR VALUE OF FUTURE POLICY BENEFITS**
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, resulting in limited changes to surplus.

## 9. LOANS PAYABLE

In prior years, the Company borrowed from an affiliated company of the minority shareholder of Barr's Bay, $6,933,906 against the $7,000,000 in promissory notes available to finance the construction of Argo House (formerly PXRE 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 31st December, 2009 was $48,327 (2008 - $118,791). Repayment of accrued interest is made separately, and began in the year 2006. Repayment of loan principal commenced in the 2005 year and it is anticipated that the loan will be fully repaid by 30th June, 2017 (contract maturity - 1st January 2026).

During the year $533,834 (2008 - $501,681) of the principal balance was repaid. Estimated principal repayments on the loan balance of $4,999,728 (2008 - $5,533,562) for the next five years are as follows:

| | $ |
|---|---|
| 2010 | 620,400 |
| 2011 | 643,994 |
| 2012 | 663,439 |
| 2013 | 688,670 |
| 2014 | 709,813 |
| Thereafter | 1,673,412 |
| | 4,999,728 |

The loan payable amount on the balance sheet is comprised of the principal amount payable of $4,999,728 (2008 - $5,533,562). Accrued interest of $48,327 (2008 - $118,791) is included in accounts payable.

## 10. POLICYHOLDER DIVIDENDS AND LOANS

Accounts payable include policyholder dividends of $5,527,804 (2008 - $5,405,803) representing dividends and interest left to accumulate by the participating policyholders. Accounts receivable include policyholder loans of $3,824,183 (2008 - $3,622,383).

## 11. CORPORATE TAXES

Corporate tax is calculated and payable on the profit of ICBL and BF&M Canada.

### (A) TAX RECOVERABLE AND DEFERRED TAXES

Accounts receivable include tax recoverable of $1,016,585 (2008 - $976,341) representing income tax on the current year profit less tax instalments paid and available credits.

Accounts payable include deferred taxes of $365,647 (2008 - $313,573) relating to the following items:

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Accelerated tax depreciation | **650,553** | 492,239 |
| Pension plan | **812,034** | 762,052 |
| | **1,462,587** | 1,254,291 |
| Deferred tax asset at depreciation tax rate of 25% | **365,647** | 313,573 |

**(B) CORPORATION TAX**

The corporation tax expense comprises:

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Current tax | **2,701,080** | 2,270,143 |
| Deferred tax | **46,320** | 95,036 |
| Taxation charge | **2,747,400** | 2,365,179 |

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

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| ICBL and BF&M Canada's income before corporation tax | **14,600,281** | 9,466,933 |
| Tax calculated at effective rates of 19% & 35% respectively | **3,236,613** | 2,420,217 |
| Effect of different tax rates on taxable income | **(250,216)** | (447,304) |
| Income not subject to tax | **(175,317)** | 233,254 |
| Tax effect of other amounts allowed | **(108,678)** | (105,222) |
| Expenses not deductible for tax | **39,244** | 37,958 |
| Tax effect of reduction in tax rate | **5,754** | 226,276 |
| | **2,747,400** | 2,365,179 |

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%. BF&M Canada's tax rate is 35%.

**(C) HAMILTON FINANCIAL**

Hamilton Financial operates in a jurisdiction with corporate tax requirements. For the years-ended 31st December, 2009 and 2008, there was no corporate tax liability for Hamilton Financial.

## 12. INTANGIBLE ASSETS

The carrying value of intangible assets and changes in the carrying value of intangible assets are as follows:

| | **Cost** | **Accumulated amortization** | **2009 Net** | 2008 Net |
|---|---|---|---|---|
| | **$** | **$** | **$** | $ |
| Finite-life intangible assets: | | | | |
| Customer lists | **6,836,359** | **3,371,197** | **3,465,162** | 4,203,096 |
| ICBL customer relationships and contracts | **5,086,472** | **2,034,589** | **3,051,883** | 3,560,530 |
| Software development costs | **16,724,287** | **5,488,384** | **11,235,903** | 13,756,754 |
| Indefinite-life intangible assets: | | | | |
| ICBL brand | **696,629** | **-** | **696,629** | 696,629 |
| | **29,343,747** | **10,894,170** | **18,449,577** | 22,217,009 |

*Customer lists*
During 2004, the Company purchased rights to certain customer lists. Payment for the customer lists was scheduled over a 4-year period commencing in 2004 and was based on a percentage of gross premiums earned. The payment made in 2007 of $487,825 was the last required payment for this purchase. The purchase costs are being amortized over a 10-year period incepting in 2004. This is the expected life of the business assumed.

During 2007, the Company purchased rights to another customer list in the amount of $1,215,000. This cost is being amortized over 10 years, being the expected life of the business assumed.

*Software development costs*
The Company is engaged with significant development of its new core information systems. Effective 1st January, 2006, all costs associated with the development of the system were deferred. Effective 1st January 2009, the Company adopted CICA Handbook Section 3064, Goodwill and Intangible Assets. The effect is to transfer internally developed software costs from property, plant & equipment to intangible assets subject to amortization.

During 2009, the Company examined the continuing future benefits of internally developed software costs, and decided to write off in 2009 $4.6 million of impaired development costs.

*Brand*
In 2005, the Company acquired intangible assets arising from the ICBL acquisition including the ICBL brand, customer relationships, and pension contracts totalling $5,783,101. Of the total intangible assets acquired, $5,086,472 was identified as the value of intangible assets that have finite lives and will be amortized over 10 years, being the estimated expected lives of the existing relationships. The remaining balance of $696,629 relates to the ICBL brand and was determined to have an indefinite life.

Impairment of these intangibles is assessed on an annual basis.

## 13. SHARE CAPITAL

### (A) SHARE CAPITAL COMPRISES:

| | **2009** | 2008 |
|---|---|---|
| | **$** | $ |
| Authorized -10,000,000 (2008 - 10,000,000) common shares of a par value of $1 each | **10,000,000** | 10,000,000 |
| Issued and fully paid - 8,339,970 (2008 - 8,327,193) common shares of a par value of $1 each | **8,339,970** | 8,327,193 |

**(i) Employee share purchase plan**
During the year 9,492 (2008 - 14,258) shares were issued under the employee share purchase plan. The fair value of the shares amounted to $151,680 (2008 - $277,785) which was credited to share capital and share premium. The discount of $22,762 (2008 - $41,686) was charged to compensation expense.

**(ii) Shares held by the Company's defined benefit pension scheme**
As at 31st December, 2009, 55,992 (2008 - 55,992) shares of the Company were owned within the investment portfolio of the Company's defined benefit pension scheme.

**(B) 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 Company's Equity Incentive Plan:

| | **# of options** | **2009 Weighted average exercise price** | # of options | 2008 Weighted average exercise price |
|---|---|---|---|---|
| Outstanding at beginning of year | **227,963** | **17.13** | 213,946 | 15.80 |
| Granted | **-** | **-** | 85,333 | 22.00 |
| Stock dividend | **-** | **-** | 20,161 | - |
| Exercised | **(3,285)** | **5.76** | (62,444) | 12.88 |
| Forfeited | **(25,512)** | **19.24** | (29,033) | 19.20 |
| Outstanding at end of year | **199,166** | **17.06** | 227,963 | 17.13 |
| Exercisable at 1st January, 2010 and 2009 | **180,500** | **16.55** | 158,296 | 15.67 |

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

| Stock options expiring 1st January | # of options outstanding | # of options exercisable as at 1st January, 2010 | Exercise price |
|---|---|---|---|
| 2012 | 7,381 | 7,381 | 6.76 |
| 2013 | 7,381 | 7,381 | 8.97 |
| 2014 | 16,473 | 16,473 | 10.50 |
| 2015 | - | - | 13.43 |
| 2016 | 52,332 | 52,332 | 16.19 |
| 2017 | 54,266 | 54,266 | 16.82 |
| 2018 | 61,333 | 42,667 | 22.00 |
| | 199,166 | 180,500 | |

The fair value of stock options granted in the year ended 31st December, 2009, was $0 (2008 - $5.76) per share, using the Black-Scholes option-pricing model with the following assumptions:

| | **2009** | 2008 |
|---|---|---|
| Expected yield | **-** | 2.63% |
| Risk free interest rate | **-** | 4.17% |
| Expected volatility | **-** | 20% |
| Expected lives | **-** | 10 years |

The amount of the benefit of the stock options granted totalled $0 (2008 - $491,518) and will be amortized through earnings as the options vest over a three year period. The amount charged to compensation expense in the current year is $110,239 (2008 - $387,750).

**(ii) Stock grants**

During the year 0 (2008 - 26,300) common shares were issued to certain key employees in respect of restricted share awards. These shares are held by the Company and are restricted from sale or use by the employees for three years from the grant date. The amount of the benefit to these key employees totalled $0 (2008 - $578,600) and will be amortized through earnings over a three year period. The amount charged to compensation expense in the current year totalled $317,729 (2008 - $428,156).

The following table summarizes information about the outstanding stock grants:

| Restricted shares vesting | # of shares |
|---|---|
| 1st January, 2010 | 21,175 |
| 1st January, 2011 | 23,050 |
| 1st January, 2012 | 0 |
| | 44,225 |

### (C) EARNINGS PER SHARE

The following sets forth the computation of basic and diluted earnings per share for the years ended 31st December, 2009 and 2008.

| | **2009** | | | 2008 | | |
|---|---|---|---|---|---|---|
| | **Income (numerator)** | **Average weighted shares (denominator)** | **Per share amount** | Income (numerator) | Average weighted shares (denominator) | Per share amount |
| Net earnings | **$19,648,220** | | | $22,171,067 | | |
| Basic earnings per share | | | | | | |
| Income available to common shares | **19,648,220** | **8,349,694** | **$2.35** | 22,171,067 | 8,292,417 | $2.67 |
| Effect of dilutive securities | | | | | | |
| Stock options | | **12,679** | | | 36,868 | |
| Diluted earnings per share | | | | | | |
| Income available to common shareholders and assumed conversions | **$19,648,220** | **8,362,373** | **$2.35** | $22,171,067 | 8,329,285 | $2.66 |

The weighted average number of shares used in the calculation of diluted earnings per share for 2009 excludes 35,510 (2008 - 73,333) share options granted to employees of the Company, as these would have been anti-dilutive.

### (D) STOCK DIVIDEND

On 24th January, 2008, the Company declared a stock dividend to shareholders of record whereby they received one common share for each ten shares held. The dividend resulted in the issuance of 749,328 shares on 29th February, 2008 and the payment of cash of $9,879 to those shareholders entitled to fractional shares. Share premium was increased by $13,299,524 and retained earnings was decreased by $14,058,728.

## 14. SEGMENTED INFORMATION

The tables below present the segments of the business based on internal management reporting. The operating segments are as follows:

### (A) HEALTH, LIFE, ANNUITY AND PENSION

Insurance coverage includes group and individual health and accident, life, disability, annuity and pension business.

### (B) PROPERTY AND CASUALTY

Insurance coverage includes personal and commercial fire, windstorm, burglary, public liability, marine, special types, personal automobile, personal autocycle, workmen's compensation and commercial vehicles.

### (C) REAL ESTATE

The Company currently owns and occupies one building and is a majority owner in two buildings that are leased principally to non-related parties.

### (D) BARBADOS OPERATIONS

Insurance coverage includes motor, property, marine, miscellaneous accident, group health, group life, and pension business.

### (E) INDUSTRY SEGMENTS

| | **Health, life, annuity and pension 2009 $'000** | **Property and casualty 2009 $'000** | **Real Estate 2009 $'000** | **Barbados operations 2009 $'000** | **Corporate and other 2009 $'000** | **Total 2009 $'000** |
|---|---|---|---|---|---|---|
| Income earned from external customers | **128,577** | **34,111** | **3,669** | **39,523** | **676** | **206,556** |
| Intersegment income | **506** | **413** | **1,099** | **-** | **3,661** | **5,679** |
| Segment amortization | **3,572** | **2,530** | **739** | **1,399** | **126** | **8,366** |
| Segment interest expense | **-** | **-** | **200** | **-** | **-** | **200** |
| Segment income tax expense | **-** | **-** | **-** | **2,650** | **97** | **2,747** |
| Segment earnings | **4,142** | **10,109** | **1,801** | **3,920** | **(324)** | **19,648** |
| Segment assets | **446,075** | **114,532** | **29,435** | **184,199** | **17,833** | **792,074** |
| Segment fixed asset & software expenditures | **1,245** | **1,190** | **165** | **868** | **96** | **3,564** |

| | Health, life, annuity and pension 2008 $'000 | Property and casualty 2008 $'000 | Real Estate 2008 $'000 | Barbados operations 2008 $'000 | Corporate and other 2008 $'000 | Total 2008 $'000 |
|---|---|---|---|---|---|---|
| Income earned from external customers | 117,542 | 32,268 | 3,218 | 39,249 | 1,039 | 193,316 |
| Intersegment income | 481 | 392 | 1,357 | - | 536 | 2,766 |
| Segment amortization | 1,365 | 427 | 745 | 1,477 | 67 | 4,081 |
| Segment interest expense | - | - | 260 | - | - | 260 |
| Segment income tax expense | - | - | - | 2,361 | 4 | 2,365 |
| Segment earnings | 4,688 | 14,094 | 1,649 | 2,324 | (584) | 22,171 |
| Segment assets | 406,389 | 99,746 | 29,096 | 191,402 | 17,368 | 744,001 |
| Segment fixed asset & software expenditures | 4,114 | 4,037 | (61) | 470 | 300 | 8,860 |

Figures included in the "corporate and other" column above represent the combined operations of two holding companies, a management company, a financial reinsurance company, and an investment management company.

The accounting policies of the segments are the same as those described in note 2. Intersegment income is recorded at management's estimate of current market prices. Reconciliation of segment income to total income, segment earnings to total earnings, and segment assets to total assets are listed below:

| | **2009** | 2008 |
|---|---|---|
| | **$'000** | $'000 |
| **INCOME** | | |
| Total income for reportable segments | **207,898** | 194,507 |
| Other income | **4,337** | 1,575 |
| Elimination of intersegment income | **(5,679)** | (2,766) |
| Total company income | **206,556** | 193,316 |
| **EARNINGS** | | |
| Total earnings for reportable segments | **19,972** | 22,755 |
| Other profit | **(324)** | (584) |
| Total company earnings | **19,648** | 22,171 |
| **ASSETS** | | |
| Total assets for reportable segments | **774,241** | 726,633 |
| Other assets | **17,833** | 17,368 |
| Elimination of intersegment assets | **(60,537)** | (51,294) |
| Total company assets | **731,537** | 692,707 |

## 15. EMPLOYEE FUTURE BENEFITS

The Company sponsors a defined benefit pension plan for employees who were hired before 1st January, 1999. The pension amount at retirement is based on an employee's final average earnings. Post-retirement indexing has been provided on an ad-hoc basis.

The Company sponsors a defined contribution pension plan for employees who were hired after 1st January, 1999 and for those who elected to convert from the defined benefit plan as of 1st January, 1999. The cost of the defined contribution pension plan is not reflected in the tables below. Contributions of $999,912 (2008 - $892,224) equating to the service cost for the year for these employees were made to this plan. The employer portion was $496,198 (2008 - $441,337).

The Company also sponsors a post-retirement benefit plan for its employees. The main benefit provided is for health care.

The total cash payments made by the Company during 2009 were $1,096,000 (2008 - $1,044,443). The cash payments consisted of contributions required to fund the pension plan and premiums paid for the other post-retirement benefit plan.

The Company measures the fair value of assets and the accrued benefit obligations as of 31st December. The most recent actuarial valuation of the pension plan for funding and accounting purposes was as of 31st December, 2009.

The following table provides summaries of the defined benefit pension and post-retirement plans' estimated financial position at 31st December, 2009 and 2008:

| | **Pension benefit plans 2009 $'000** | Pension benefit plans 2008 $'000 | **Other benefit plans 2009 $'000** | Other beneift plans 2008 $'000 |
|---|---|---|---|---|
| **ACCRUED BENEFIT OBLIGATION** | | | | |
| Balance - Beginning of year | **39,628** | 37,878 | **9,900** | 9,047 |
| Current service cost | **1,044** | 909 | **900** | 808 |
| Interest cost | **2,810** | 2,275 | **720** | 525 |
| Benefits and expenses paid | **(1,514)** | (1,412) | **(254)** | (202) |
| Actuarial loss | **5,265** | (21) | **1,048** | (278) |
| **BALANCE - END OF YEAR** | **47,233** | 39,629 | **12,314** | 9,900 |
| **PLAN ASSETS** | | | | |
| Fair value - Beginning of year | **39,260** | 44,495 | **-** | - |
| Actual return on plan assets | **(1,631)** | (4,668) | **-** | - |
| Contributions | **845** | 845 | **251** | **199** |
| Benefits and expenses paid | **(1,514)** | (1,412) | **(251)** | **(199)** |
| **FAIR VALUE - END OF YEAR** | **36,960** | 39,260 | **-** | - |
| Funded Status - plan (deficit) surplus | **(10,273)** | (369) | **(12,314)** | (9,900) |
| Unamortized net actuarial loss | **16,298** | 6,616 | **554** | (27) |
| Unamortized transitional (asset) obligation | **(2,532)** | (2,785) | **1,490** | 1,640 |
| **ACCRUED BENEFIT ASSET (LIABILITY)** | **3,493** | 3,462 | **(10,270)** | (8,287) |

Plan assets consist of the following:

| | **2009 %** | 2008 % |
|---|---|---|
| Equities | **15** | 25 |
| Fixed income | **68** | 56 |
| Real estate | **9** | 9 |
| Other | **8** | 10 |
| Total | **100** | 100 |

The significant actuarial assumptions adopted in measuring the Company'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 31st December, 2009 and 2008):

| | **Pension benefit plans 2009 %** | Pension benefit plans 2008 % | **Other benefit plans 2009 %** | Other beneift plans 2008 % |
|---|---|---|---|---|
| **BERMUDA** | | | | |
| **Benefit cost during the year** | | | | |
| Discount rate | **7.00** | 5.50 | **7.00** | 5.50 |
| Expected long-term rate of return on plan assets | **7.00** | 7.00 | | |
| Rate of compensation increase | **5.50** | 4.00 | | |
| **Accrued benefit obligation at end of year** | | | | |
| Discount rate | **6.00** | 7.00 | **6.00** | 7.00 |
| Compensation increase | **5.50** | 5.50 | | |
| Post-retirement indexation | **2.25** | 2.25 | | |

For measurement purposes, the annual rate of increase in the per capita cost of covered health care benefits was assumed to be 9% for year 2008, 8.5% for years 2009 to 2013, 6.5% for years 2014 to 2018, and 4.5% thereafter.

| | **Pension benefit plans 2009 %** | Pension benefit plans 2008 % | **Other benefit plans 2009 %** | Other beneift plans 2008 % |
|---|---|---|---|---|
| **BARBADOS** | | | | |
| **Benefit cost during the year** | | | | |
| Discount rate | **7.00** | 7.50 | **7.00** | 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 | **7.00** | 7.50 | **6.50** | 7.50 |
| Compensation increase | **6.00** | 6.00 | | |
| Post-retirement indexation | **2.50** | 2.50 | | |

Medical premium inflation in Barbados was assumed to be 5% (2008 - 5%).

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

| | **Pension benefit plans 2009 $'000** | Pension benefit plans 2008 $'000 | **Other benefit plans 2009 $'000** | Other beneift plans 2008 $'000 |
|---|---|---|---|---|
| Current service cost | **1,044** | 909 | **900** | 808 |
| Interest cost | **2,810** | 2,275 | **720** | 525 |
| Actual return on plan assets | **1,604** | 4,668 | **-** | - |
| Actuarial (gains) losses | **5,265** | (21) | **1,047** | (278) |
| **NET BENEFIT PLAN EXPENSE BEFORE ADJUSTMENTS** | **10,780** | 7,831 | **2,668** | 1,055 |
| **ADJUSTMENTS TO RECOGNIZE THE LONG-TERM NATURE OF EMPLOYEE FUTURE BENEFIT COSTS** | | | | |
| Difference between expected and actual return on plan assets | **(4,611)** | (7,602) | **-** | - |
| Difference between recognized and actual actuarial loss | **(5,070)** | 8 | **(1,047)** | 261 |
| Amortization of transitional (asset) obligation | **(253)** | (253) | **150** | 150 |
| **NET BENEFIT PLAN EXPENSE** | **816** | (16) | **1,770** | 1,466 |

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 health care cost as follows:

| | **Increase 2009 $'000** | Increase 2008 $'000 | **Decrease 2009 $'000** | Decrease 2008 $'000 |
|---|---|---|---|---|
| Aggregate of current service cost and interest cost | **456** | 273 | **(335)** | (214) |
| Accrued benefit obligation | **3,426** | 1,501 | **(2,519)** | (1,221) |

## 16. ESTIMATED FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company's financial instruments comprise all assets and liabilities, except for the reinsurers' share of provision for unearned premiums, property, plant and equipment, intangible assets, goodwill, unearned premiums, deferred commission income, deferred net realized gains on bonds and equities and the non-controlling interest in subsidiaries.

The fair value of the Company's financial instruments, which are not classified as either held for trading or available for sale approximate the carrying values in the balance sheet except for certain investments, the fair value of which is disclosed in note 4, and the Barr's Bay's loan with a minority shareholder which has an interest rate 2% below the average of the prevailing First Mortgage rates of banks in Bermuda. The cash flows of the Barr's Bay loan have been discounted using a market interest rate. The fair value of the loan, recorded in the Company's balance sheet at $4,999,728 (2008 - $5,533,562), is $4,669,598 (2008 - $5,145,201).

## 17. DIRECTORS' AND OFFICERS' SHARE IN INTERESTS AND SERVICE CONTRACTS

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 Company in the common shares of the Company at 31st December, 2009 were 245,602 (2008 - 216,860) shares. No rights to subscribe for shares in the Company have been granted to or exercised by any director or officer, other than those disclosed in note 13(b).

There are no service contracts with directors.

Outstanding loans to directors amounted to $338,305 (2008 - $441,225) at 31st December, 2009.

## 18. MAINTENANCE OF NET WORTH AGREEMENT

On 17th March, 2006, an agreement was signed between the Company and Bermuda International whereby the Company 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 Company 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 International. The Company 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. The minimum net worth amount is $250,000. If Bermuda International falls below the minimum net worth amount it will notify the Company and the Company will provide funds to Bermuda International within 10 business days.

## 19. INSURANCE AND OTHER COMPANY REGULATIONS

### CURRENT

**Bermuda**

Under The Insurance Act 1978 (Bermuda), Amendments Thereto and Related Regulations (the "1978 Act"), the Company'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 Company's insurance subsidiaries to meet minimum liquidity ratios and minimum capital and surplus requirements which vary depending on whether they are a Long-Term Insurer or not. Non Long-term insurance companies, which have a Class 3A insurance license, must maintain a minimum capital and surplus equal to the greater of $1.0 million, 20% of the first $6.0 million of net premiums written and 15% of the net premiums written in excess of $6.0 million or 15% of the loss and loss expense provisions. Long-Term insurance companies must maintain a minimum capital and surplus of $250,000. The total restricted statutory capital and surplus required to be held by the Company's insurance subsidiaries as at 31st December, 2009 was $4,352,696 (2008 - $4,613,537). For all periods presented herein, the Company satisfied these requirements.

The 1978 Act limits the maximum amount of annual dividends and distributions that may be paid by the Company's insurance subsidiaries. These insurance companies shall not pay dividends in any year which would exceed 25% of its prior year statutory capital and surplus or reduce its prior year statutory capital by 15% or more, without the prior notification to, and in certain cases the approval of, the BMA. In addition, The Bermuda Companies Act 1981 (the "Companies Act") limits the Company's ability to pay dividends and distributions to shareholders if there are reasonable grounds for believing that the company 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.

BF&M General and Bermuda International Re were formerly registered under the 1978 Act as a Class 3 insurer. In July 2008, the Bermuda House of Assembly passed the Insurance Amendment Act (the "2008 Act") which created new classes of insurer. In accordance with the 2008 Act, these companies have applied for re-registration with the Bermuda Monetary Authority ("BMA") as Class 3A insurers.

**Barbados**

The Barbados Insurance (Catastrophe Reserve Fund) Regulations 1998 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 and are accounted for as an appropriation of retained earnings in the financial statements of ICBL. Assets representing the fund in the amount of $3,218,478 (2008 - $2,904,759) are placed in trust in accordance with the regulations of the 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 $14,157,405 as at 31st December, 2009 (2008 - $11,393,485) is included in ICBL's shareholders' equity.

**FUTURE**

**Bermuda**

The Bermuda Monetary Authority during 2009 published consultation papers on a revised regulatory framework, capital and solvency for long-term insurers, and the transition to an 'Own Risk and Solvency Assessment. The Company anticipates an implementation of the revised solvency framework by 2011. The Company expects the minimum level of statutory capital and surplus will increase as a result of the revised solvency framework; however the Company is unable to assess the impact at this time.

## 20. COMPARATIVE FIGURES

Certain comparative figures have been restated to reflect the current year's financial statement presentation.

During 2008, ICBL changed its basis for calculating reinsurance recoveries on its IBNR reserves. This had no change to the net assets of the Company and only adjusted the gross and net IBNR presented in the Consolidated Balance Sheet.

# DIRECTORS AND OFFICERS OF PRINCIPAL OPERATING SUBSIDIARIES

## BF&M GENERAL INSURANCE COMPANY LIMITED

| | |
|---|---|
| DIRECTORS | **Nancy L. Gosling,** B.Com., C.G.A. *Chairman* |
| | **Peter N. Cooper,** *Deputy Chairman* |
| | **Gavin R. Arton** |
| | **Gregory D. Haycock,** FCA., J.P. |
| | **L. Anthony Joaquin,** FCA |
| | **R. John Wight,** C.A., CPCU |
| | **David A. J. G. White** |
| | **Glen 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* |
| | **Janet Carew,** C.A., *Chief Financial Officer* |
| | **Goulbourne Alleyne,** FCII, ARe, ACIS, MBA, CAMS, *Vice President, Underwriting & Claims* |
| | **Lynda A. Davidson Leader,** C.A., *Vice President, Corporate Services* |
| | **Paul Matthews,** *Vice President, Information Technology* |
| | **Patrick Neal,** B.A., CPCU, *Vice President, Bancassurance* |
| | **Henry Sutton,** CPCU, ARe, *Vice President, Customer Relations* |
| | **Andrew Hanwell,** *Assistant Vice President, Personal Insurance* |
| | **Nicole Williams Smith,** B.A., *Assistant Vice President, Communications* |
| ACTUARIAL | **Mylene Labelle,** FCIA, FCAS, **(Eckler Partners Limited, Toronto),** *Consultant Actuary* |

## BF&M LIFE INSURANCE COMPANY LIMITED

| | |
|---|---|
| DIRECTORS | **Garry A. Madeiros,** FCA., J.P., *Chairman* |
| | **Stephen W. Kempe,** *Deputy Chairman* |
| | **Gavin R. Arton** |
| | **Catherine S. Lord,** B.Sc., J.P. |
| | **S. Caesar "Sy" Raboy,** CLU |
| | **C.L.F. "Lee" Watchorn,** FCIA, FSA |
| | **R. John Wight,** C.A., CPCU |
| | **Lynne A. Woolridge,** BSc., FLMI, FALU, HIA |
| OFFICERS | **R. John Wight,** C.A., CPCU, *President & Chief Executive Officer* |
| | **Lynne A. Woolridge,** BSc., FLMI, FALU, HIA, *Senior Vice President* |
| | **Janet Carew,** C.A., *Chief Financial Officer* |
| | **Lynda A. Davidson Leader,** C.A., *Vice President, Corporate Services* |
| | **Holly Flook,** RN, BSN, *Vice President, Underwriting & Claims* |
| | **Michael Lima,** *Vice President* |
| | **Paul Matthews,** B.A., PMP, *Vice President, Information Technology* |
| | **Alyson L. Nicol,** C.A., C.P.A., *Vice President, Pensions* |
| | **Daniel Fairfield,** A.S.A., *Life Actuary* |
| | **Nicole Williams Smith,** B.A., *Assistant Vice President, Communications* |
| ACTUARIAL | **Sylvain Goulet,** F.S.A., F.C.I.A., M.A.A.A., **(Eckler Partners Limited, Toronto),** *Consultant Actuary* |

## DIRECTORS AND OFFICERS OF PRINCIPAL OPERATING SUBSIDIARIES *(continued)*

### BERMUDA INTERNATIONAL INSURANCE SERVICES LIMITED

| | |
|---|---|
| DIRECTORS | **R. Blake Marshall,** B.B.A., M.Sc., C.A., *Chairman*<br>**Richard D. Spurling,** *Deputy Chairman*<br>**S. Caesar "Sy" Raboy,** CLU<br>**C.L.F. "Lee" Watchorn,** FCIA, FSA<br>**R. John Wight,** C.A., CPCU<br>**Michael Lima** |
| OFFICERS | **R. John Wight,** C.A., CPCU, *President & Chief Executive Officer*<br>**Michael Lima,** *Vice President & General Manager* |

### BERMUDA INTERNATIONAL REINSURANCE SERVICES LIMITED

| | |
|---|---|
| DIRECTORS | **R. Blake Marshall,** B.B.A., M.Sc., C.A., *Chairman*<br>**Richard D. Spurling,** *Deputy Chairman*<br>**S. Caesar "Sy" Raboy,** CLU<br>**C.L.F. Lee Watchorn,** FCIA, FSA<br>**R. John Wight,** C.A., CPCU, |
| OFFICERS | **R. John Wight,** C.A., CPCU, *President & Chief Executive Officer*<br>**Lynne Woolridge,** BSc, FLMI, FALU, HIA, *Senior Vice President* |

### MARCHMONT INSURANCE COMPANY LIMITED

| | |
|---|---|
| DIRECTORS | **R. Blake Marshall,** B.B.A.,M.Sc., C.A., *Chairman*<br>**Richard D. Spurling,** *Deputy Chairman*<br>**R. John Wight,** C.A., CPCU<br>**Lynda A. Davidson Leader,** B.A., C.A. |
| OFFICERS | **R. John Wight,** C.A., CPCU, *President & Chief Executive Officer*<br>**Emma Atherton,** *Vice President*<br>**S. Andrew White,** ARM, *Assistant Vice President & Manager* |

### BF&M INVESTMENT SERVICES LIMITED

| | |
|---|---|
| DIRECTORS | **Stephen W. Kempe,** *Chairman*<br>**Gavin R. Arton,** *Deputy Chairman*<br>**R. John Wight,** C.A., CPCU<br>**Lynda A. Davidson Leader,** C.A. |
| OFFICERS | **R. John Wight,** C.A., CPCU, *President & Chief Executive Officer*<br>**Miguel DaPonte,** C.F.A., M.B.A., *Vice President* |

### INSURANCE CORPORATION OF BARBADOS LIMITED

| | |
|---|---|
| DIRECTORS | **R. John Wight,** C.A., CPCU *Chairman*<br>**Carlos Holder,** J.P., B.A. (Hons), M.A. (Econ), *Vice Chairman*<br>**Wismar Greaves,** B.A., A.C.I.I., **Chartered Insurer**<br>**Winston Beckles,** LL.B., LL.M. (Lond.)<br>**Francina Downey,** C.G.A., F.C.A.<br>**Barry L.V. Gale,** Q.C. LL.B. (Hons )<br>**Eric Smith**<br>**Juanita Thorington-Powlett,** BSc., M.B.A., F.C.I.S.<br>**Clyde Q. Williams,** B.A., CLU, FLMI, CPA<br>**Toni M.D. Jones**<br>**Adrian D. Christie** |
| OFFICERS | **Wismar Greaves,** B.A., A.C.I.I., **Chartered Insurer,** *Managing Director & Chief Executive Officer*<br>**Valentina J.G.R. Blackman,** LL.B. (Hons), LL.M (UWI) *Secretary* |

## BF&M Employees

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