
BERMUDA MONETARY AUTHORITY

Regulatory Update
February 2006

*(Incorporating Financial Statistics for the
Quarter ended September 2005)*

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(I) REGULATORY DEVELOPMENTS

a) Investments

New Collective Investment Schemes Exemption and EUSD

The Ministry of Finance, in consultation with the Authority, has introduced a new exemption for certain collective investment schemes (CIS) from Bermuda's existing CIS Regulations. Non-retail funds offered exclusively to sophisticated investors can now seek exemption from classification under the Regulations. Those funds must, however, be registered by the Bermuda Monetary Authority and have to meet certain criteria, including appointing an auditor, appointing a recognised fund administrator and retaining a local representative in Bermuda. Such exempted funds are regarded as out of scope for the purposes of the European Union Savings Directive (EUSD), specifically where Swiss paying agents are involved.

b) Banking and Trust

Updates to Capital Adequacy Framework for Banks and Deposit Companies

The Authority is currently consulting deposit-taking institutions on some of its proposals for implementation of the Basel II framework, and the relevant consultative papers are also being copied to licensed investment businesses, given their relevance to parts of this sector. Among other matters, Basel II will involve a further series of amendments to the revised capital measurement framework included in the Authority's draft consultative paper, *The Assessment and Measurement of Capital Adequacy*, issued in December 2005. These will involve, for example, extensive changes to the measurement framework for credit risk, the introduction of a specific operational risk requirement, and various enhancements to the Authority's on-site compliance reviews to reinforce the risk-based nature of its oversight, with particular focus upon aspects of governance and internal control arrangements used by institutions.

The Authority will be bringing forward detailed proposals on these and other Basel II-related issues, all of which will be the subject of consultation with the market during 2006 and 2007 as arrangements for implementation of Basel II are finalised.

(II) LEGISLATIVE DEVELOPMENTS

a) Enactment of Amendment Legislation for Banking, Trust and Investment Business

At the end of 2005, Parliament passed the Bank and Deposit Companies Amendment Act 2005, the Trusts (Regulation of Trust Business) Amendment Act 2005, and the Investment Business Amendment Act 2005. All three Acts will come into force shortly. These Acts make new provisions that clarify the reporting obligations of auditors and reporting accountants (i.e. auditors and accountants who are charged with a statutory duty to report to the Authority). The provisions allow the Minister of Finance to prescribe by regulations the facts and matters reporting auditors and accountants must report to the Authority. Relevant regulations related to the Acts are currently being prepared.

b) Proceeds of Crime Act and Regulations Amendments

The Authority is currently reviewing feedback and comments received from industry groups and representative bodies regarding the proposed amendments to the Proceeds of Crime Act and Regulations, and related Guidance Notes. The amendments seek to, among other matters, increase the scope of the relevant regulations to capture a range of non-financial businesses, e.g. realtors, lawyers, accountants; reinforce the information sharing capabilities of the Financial Intelligence Unit; and clarify the Authority's responsibilities as regards monitoring regulated institutions' compliance with the Act.

c) Insurance

Insurance Amendment Act - Proposed Further Amendments

The Authority has begun the consultative process with industry regarding further amendments to the Insurance Act 1978. The proposed amendments are part of the Authority's continued enhancement of the regulatory framework for insurance in line with international standards, and also seek to ensure that supervision of the industry remains appropriate to the nature of the business conducted and the counterparties involved. The Authority anticipates that the amendments will be tabled in Parliament during 2006.

Insurance Guidance Notes

The Authority has received constructive feedback from industry regarding the draft Guidance Note on the *Role of the Loss Reserve Specialist*. Based on this feedback, the Authority has made revisions to the Guidance Note, which now provides further clarification on the methodology and assessment of loss reserve provisions. The Guidance Note will be released to industry before the end of February 2006.

(III) OTHER DEVELOPMENTS

a) IAIS Paper - A New Framework for Insurance Supervision

The International Association of Insurance Supervisors (IAIS) has released its plan regarding the establishment of a common structure for assessing insurer solvency. The plan, known as *The Roadmap for a Common Structure and Common Standards for the Assessment of Insurer Solvency*, gives priority to three areas:

- i. Improving transparency of existing solvency regimes and the financial condition of insurers worldwide
- ii. Working towards convergence of the solvency regimes and supervisory assessment
- iii. Developing a level playing field for industry

The ultimate goal is to develop a common set of international standards that will address financial, reporting, governance and market conduct issues related to insurer solvency. The standards will direct the extent to which supervisors should take these issues into account when assessing insurer solvency, and will provide the basis for a coherent supervisory approach. The Authority is reviewing the implications of the IAIS proposals for Bermuda's framework for insurance supervision and has begun consultations with the industry in this regard.

b) G30 (Group of Thirty) Report on Reinsurance and International Financial Markets

The Authority is reviewing the recently published G30 report addressing the role of reinsurance in the international capital markets and issues related to transparency and regulation of the industry. The report provides an overview of the reinsurance industry and then examines four major areas:

- i. Whether reinsurance adds substantially to systemic risk in the international financial system as a whole
- ii. The securitisation of insurance risk and the G30 view that there is a need to reduce barriers to the growth of this business
- iii. How transparency in the industry can be increased, particularly via risk-based disclosure; and
- iv. The nature of existing regulatory frameworks for the industry globally, and the recommendation that supervisors worldwide should adopt a regulatory approach that reviews the condition and activities of reinsurance groups on a consolidated basis, using a risk-based framework

The Authority, in common with other reinsurance regulators globally, is reviewing the recommendations of the Report to assess their implications for Bermuda's framework for reinsurance regulation.

The G30, established in 1978, is an influential private, non-profit, international body composed of very senior representatives of the private and public sectors and academia. Its primary stated objective is to explore issues of business practice and public policy and suggest measures to address systemic risk and improve the functioning of the international financial system.

c) Balance of Payments Estimates

The responsibility for compiling Bermuda's Balance of Payments estimates has moved from the Bermuda Monetary Authority to the Bermuda Government Department of Statistics. This transfer of responsibility is a logical result of the introduction of the Statistics Act 2002, which provides that one of the duties of the Chief Statistician is: "to collect, compile, collate, analyse, abstract and publish statistical information relating to the commercial, industrial, social, financial, economic, and general activities and conditions of the people of Bermuda".

The Bermuda Monetary Authority maintained responsibility for compiling the data for the first two quarters of 2005, while assisting the Department of Statistics in preparing for a smooth transition. The Department of Statistics has now taken over the preparation of the estimates for the third quarter of 2005 and subsequent periods.

d) Seminars, Conferences and Publications

Cheryl-Ann Lister, Chairman and CEO, spoke as a member of a panel at the Securities and Exchange Commission Institute on Enforcement and Market Oversight, which took place in Washington on November 14th 2005.

Mrs. Lister was also the keynote speaker at the Annual Dinner of the Bermuda Society in London on November 16th 2005.

Mrs. Lister also presented an overview of Bermuda regulation with respect to Collective Investment Schemes at two events in London, a CFO Breakfast Forum and a Bermuda International Business Association briefing event for senior financial services company executives, on January 24th and 25th 2006 respectively.

Munro Sutherland, Superintendent of Banking, Trust and Investment was a speaker at the Caribbean Association of Securities Regulators conference which took place in Jamaica from November 7th - 8th 2005.

William Kattan, Director of Legal Services and Enforcement and **Pat Phillip-Bassett**, Assistant Director, Communications, attended the International Monetary Fund Roundtable for Offshore and Onshore Supervisors and Standard-Setters, which took place from November 17th - 18th 2005 in Sydney. Discussions focused heavily on issues related to cross-border cooperation and information exchange among regulators.

Shelby Weldon, Deputy Director, Insurance (Compliance), **Shanna Lespere**, Deputy Director, Insurance (Licensing and Authorisations) and **Suzanne Williams**, Principal, Compliance attended the 17th Annual Executive Conference for Property-Casualty Industry, on November 17th and 18th 2005, entitled *Managing Change in a Dynamic Environment*. Topics discussed included reserve adequacy, capital and risk management, terrorism risk and the outcome of TRIA.

Ann Daniels, Assistant Director, Banking and Trust attended an Executive Banking Forum held by the Toronto Centre for Leadership which took place from November 8th to 11th 2005. Topics discussed included the readiness of financial institutions and regulatory agencies for Basel II and corporate governance as a supervisory tool.

Jeremy Cox, Supervisor of Insurance, attended the National Association of Insurance Commissioners Winter National Meeting, which was held in Chicago, Illinois from December 3rd - 6th 2005.

Special Feature - Development of the Capital Adequacy Regime for Bermuda's Investment Businesses

As part of the Authority's on going review of Bermuda's regulatory framework, consultations are currently underway with the investment business sector regarding a number of proposed developments in the capital adequacy framework. The proposed changes relate to those firms holding or trading material portfolios as principal, as well as those from which consolidated group supervision is relevant. While the changes mark an important development of the Authority's framework for capital adequacy, they will apply only to the small number of firms and groups for which they are appropriate. The present fixed capital tests applying to the generality of firms licensed under the Investment Business Act 2003 (the Act) will continue to apply in most cases.

The Act currently provides that licensed investment businesses must, among other things, maintain minimum net assets as directed by the Authority. Generally, the level of minimum assets applied by the Authority varies according to whether the licensed investment entity is conducting business as a principal, agent or otherwise. However, under the Statement of Principles issued under the Act in March 2004, the Authority explains that in certain circumstances it may require an investment provider to maintain higher levels of assets, for example if it holds material principal positions or conducts substantive non-investment business. Such tests have in the past been applied on very much an ad hoc basis. The intention now is to provide a standardised risk-based approach that can be applied in appropriate cases.

The Statement of Principles also explains the circumstances in which the Authority may undertake consolidated supervision of Bermuda-based investment businesses. In practice, the Authority has not to date developed and applied consolidated capital tests to investment businesses, other than for business conducted within banking groups. However, the Authority now proposes to develop appropriate methodologies for applying consolidated supervision, including the incorporation of the new risk-based methodologies for calculating capital as appropriate. As with banks, this new framework means that, for relevant firms, capital would be monitored on both a solo and a consolidated basis.

The application of consolidated supervision to groups containing multiple financial services businesses has now become normal practice internationally. It has, in particular, been a fundamental element of the financial supervision of all groups containing a bank for very many years. Consistent with these international standards, Bermuda's banks are already fully subject to consolidated group-wide supervision, in compliance with the principles developed by the Basel Committee on Banking Supervision, the international standard-setting body. Increasingly, these principles are now being applied to other forms of financial services business.

Accordingly, regulators are required to supervise banks and investment businesses on both a solo and, where appropriate, consolidated basis, within a standard framework for defining capital and for calculating the risks inherent in investment and banking business. This development reflects the close cooperation between the respective international standard-setting bodies - the Basel Committee for banks and the International Organisation of Securities Commissions (IOSCO) for investment business.

Many Bermuda-based investment businesses now provide investment services internationally, either on a cross-border basis or through the operations of branches and subsidiaries overseas. Therefore, it is becoming increasingly important for them to be able to confirm they are subject in their home jurisdiction to risk-based consolidated capital adequacy requirements that are consistent with the new international standards.

This is a particular issue, for example, for investment providers seeking to conduct business within the European

Union (EU). In the EU firms must be able to demonstrate that they are subject to equivalent group-wide supervision if they are to avoid the need for separate regulatory requirements being applied to their EU operations or sub-group. The Authority proposes to implement and apply enhanced capital adequacy requirements for investment providers that are consistent with the international standards for capital adequacy approved by IOSCO and the Basel Committee.

The enhanced capital adequacy approach that is proposed for investment businesses will also reflect the outcome of a number of other proposals currently being discussed with Bermuda's banks and deposit companies, in preparation for implementation of the Basel II Accord (see '*Updates to Capital Adequacy Framework for Banks and Deposit Companies*' section earlier in this Regulatory Update). The enhanced capital adequacy approach for investment businesses will, therefore, involve the use of the amended capital definitions, banking book/trading book analysis, and measurement frameworks as set out in the consultative paper '*The Assessment and Measurement of Capital Adequacy: Banks and Deposit Companies*', issued to industry in December 2005. This consultative paper represents a first stage in developing the current capital adequacy rules for banks, and the Authority expects to complete industry consultations during the current quarter. Thereafter, the framework document will be further developed and refined as Bermuda moves to complete its implementation of the Basel II requirements.

The measurement framework for capital adequacy represents only one element of the Authority's prudential supervision of regulated institutions. The Authority supplements off-site analysis of financial data, including capital adequacy, with regular prudential meetings with senior management. It also conducts on-site visits to regulated institutions, during which it undertakes detailed assessments of business systems and control tests firms' compliance with legislative and other requirements. This basic approach applying to both banks and investment businesses will be subject to some further enhancement over the next few years.

The entire consultative paper '*Investment Business Act 2003: Risk-based Capital Requirements*' is available for review and comment on the Bermuda Monetary Authority website www.bma.bm

STATISTICAL ANNEXE

BERMUDA MONEY SUPPLY

(BD\$ millions)	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2	2005-Q3
Notes & Coins in Circulation*	90	90	100	93	93	98
Deposit liabilities:						
Banks and Deposit Companies (unconsolidated)	3,491	3,544	3,558	3,579	3,562	3,510
	3,581	3,635	3,658	3,672	3,655	3,609
Less: Cash at Banks and Deposit Companies	24	23	27	26	28	25
BD\$ Money Supply	3,557	3,612	3,630	3,646	3,628	3,583
% Growth on Previous Period	3.06%	1.52%	0.51%	0.43%	-0.50%	-1.22%
% Growth Year on Year	13.79%	12.14%	10.09%	5.63%	1.97%	-0.79%

* This table includes the supply of Bermuda dollars only. United States currency is also in circulation in Bermuda but the amount has not been quantified.

* Data reported for the period 2005-Q2 have been amended from the previously reported figures to reflect industry information received subsequent to the specified period.

BD\$ DEPOSIT PROFILE - COMBINED BANKS AND DEPOSIT COMPANIES (Unconsolidated)

(BD\$ Millions)	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2	2005-Q3
Deposit Liabilities	3,491	3,544	3,558	3,579	3,562	3,510
Less:						
Loans, Advances and Mortgages	(2,667)	(2,752)	(2,865)	(2,942)	(3,079)	(3,281)
Surplus deposits	824	792	693	637	484	230
Percentage of Deposit Liabilities Lent	76.4%	77.6%	80.5%	82.2%	86.4%	93.5%

COMBINED BANKS AND DEPOSIT COMPANIES FOREIGN CURRENCY
(Consolidated)

<u>(BD\$ millions)</u>	2004 - Q2	2004 - Q3	2004 - Q4	2005 - Q1	2005 - Q2	2005 - Q3
Total Foreign Currency Assets	20,948	19,252	17,221	19,211	15,621	16,109
Less: Other Assets	323	241	284	285	265	285
Less: Foreign Currency Loans to Residents	854	753	850	917	995	1,086
Net Foreign Currency Assets	19,772	18,257	16,087	18,009	14,361	14,739
Foreign Currency Liabilities	18,926	17,324	15,278	17,253	13,517	14,212
Add: BD\$ Deposits of Non-Residents	176	161	142	117	124	117
Net Foreign Currency Liabilities	19,101	17,485	15,420	17,370	13,641	14,328
Net Foreign Currency Position (consolidated)	670	772	667	640	720	411

Totals may not add due to rounding

COMPANIES PARTNERSHIPS & PERMITS STATISTICS

APPLICATIONS APPROVED SUMMARY Q3-2005

	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2	2005-Q3
Exempted Companies (Bermuda companies exempted from the 60% Bermudian ownership requirement)	244	260	287	266	229	249
Exempted Partnerships (partnerships established in Bermuda to carry on business in or from within Bermuda)	11	13	27	23	30	22
Overseas Partnerships (overseas partnerships applying for permits to carry on business in or from within Bermuda)	1	0	2	2	0	1
Overseas Permit Companies (overseas companies applying for permits to carry on business in or from within Bermuda)	14	3	10	13	7	4
Unit Trusts	3	10	19	12	14	10
Continuation Companies (companies from other jurisdictions continuing into Bermuda as exempted companies)	8	3	11	4	5	7
Unlimited Liability Companies	0	0	1	0	0	0
Local Companies	62	48	53	62	54	50
Total Applications Approved	343	337	410	382	339	343

COLLECTIVE INVESTMENT SCHEMES STATISTICS

	2004-Q2	2004-Q3	2004-Q4	2005-Q1	2005-Q2	2005-Q3
Mutual Funds	764	785	809	836	849	836
Umbrella Funds	69	72	70	64	67	60
Sub-Funds	295	263	354	378	405	328
Segregated Account Companies	20	26	29	38	45	49
Segregated Accounts	87	137	159	177	247	290
Total	1,235	1,283	1,421	1,493	1,613	1,563
Unit Trusts	65	74	96	100	105	101
Umbrella Trusts	69	69	72	74	81	71
Sub-Trusts	158	82	166	180	227	211
Total	292	225	334	354	413	383
TOTAL PORTFOLIOS	1,527	1,508	1,755	1,847	2,026	1,946
TOTAL NUMBER OF SCHEMES	987	1,026	1,076	1,112	1,147	1,117
TOTAL NET ASSET VALUE (IN BILLIONS)	\$133.02	\$141.25	\$158.18	\$166.50	\$178.58	\$180.01

Note: Data reported for the period 2004-Q2 to 2005-Q2 have been amended from the previously published figures to eliminate a number of liquidated and dormant funds that had been inadvertently included. A number of separate share classes incorrectly shown as Sub-Funds and Sub-Trusts have also been eliminated from the data.

ADDITIONS TO THE INSURANCE REGISTER

	2004 Q2	2004 Q3	2004 Q4	2005 Q1	2005 Q2	2005 Q3
Class 1	10	4	11	2	3	3
Single-parent captive insuring only risks of its owners or affiliates of the owners						
Class 2	1	0	4	3	3	3
(a) a multi-owner captive insuring risks of its owners or affiliates of the owners;						
(b) a single-parent and multi-owner captive:						
(i) insuring the risks related to or arising out of the business or operations of the owners and affiliates, and/or						
(ii) deriving up to 20 percent of its net premiums from unrelated risks						
Class 3	3	6	10	6	7	3
Insurers not included in Class 1, 2 or 4, such as						
i) Reinsurers writing third party business;						
ii) Insurers writing direct policies with third party individuals;						
iii) Single parent, group, association, or joint venture captives where more than 20% of their net premiums written arises from risks which are unrelated to the business of the owners;						
iv) Finite reinsurers and rent-a-captives						
Class 4	0	1	0	0	0	0
Insurers and reinsurers capitalised at a minimum of \$100 million underwriting direct excess liability and/or property catastrophe reinsurance risk						
Long-Term Insurers	2	2	5	3	3	1
Insurers writing long-term (or life) business						
Composites	0	1	0	0	0	0
Insurers writing combination of long-term (or life) business and Class 1, 2, 3 or 4 business						
Total additions during quarter	16	14	30	14	16	10

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