



BERMUDA MONETARY AUTHORITY

Regulatory Update
December 2006

*(Incorporating Financial Statistics for the
Quarter ended June 2006)*

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(I) REGULATORY DEVELOPMENTS

a) Money Service Business Regulations

The Authority will shortly be introducing a new regulatory regime that will bring money service businesses directly under its supervision. The new regime will enable persons seeking to conduct and provide certain financial services in Bermuda (notably money transmitters, bureaux de change, cheque cashers etc.) to obtain a licence from the Authority via Regulations under the BMA Act. The Authority has finalised the Regulations following extensive market consultation and they are due to come into effect shortly. The intention with these new arrangements is to liberalise the provision of these services, which previously had to be conducted under the auspices of banks or other authorised dealers, while still providing an appropriate level of regulatory supervision. Therefore, new money service businesses will also be regulated institutions under Proceeds of Crime regulations and subject to supervision by the Authority. That supervision will also include inspection to ensure compliance with anti-money laundering requirements.

b) Banks and Deposit Companies

Updates to Capital Adequacy Framework for Banks and Deposit Companies

The Authority has finalised and published on its website - in a paper entitled - '*The Assessment and measurement of Capital Adequacy for Banks and Deposit Companies*' - the first part of a major update and enhancement to the capital adequacy rules for banks and deposit companies. The changes described in the paper relate to implementation of detailed rules for the calculation of capital requirements covering material market risk exposures run by banks. The Authority finalised the paper after extensive consultation with Bermuda's banks that has proceeded through 2006. These important changes are the first stage of a series of enhancements on which the Authority continues to consult with industry, related to the planned implementation of the new Basel II requirements. As well as the new paper, the Authority also published new related reporting schedules in the form of additions to the BMA's Prudential Information Returns for institutions, together with related amendments to the reporting instructions.

Basel II: Pillar I - Operational Risk

The Authority continued consultations with the banks on the various new provisions Bermuda will need to introduce into existing regulatory rules as part of Basel II implementation. In particular, the Authority held initial bilateral discussions with institutions on new requirements for the assessment and control of their operational risks. These requirements will include new capital charges that will be levied under Basel II, depending on regulators' assessments of these operational risks. The Authority will be publishing a follow-up paper on operational risk shortly, as well as continuing with further bilateral meetings with individual institutions during the final part of the year. Additional consultative papers on aspects of both Pillar I and Pillar II of the new Basel framework are also in preparation and will be circulated over the coming months, with a view to enabling the Authority to implement Basel II as from the beginning of 2009.

(II) LEGISLATIVE DEVELOPMENTS

a) Investment Funds Act 2006

Drafting of the Investment Funds Act 2006 has been completed, and the intention is that this new Bill will be

introduced into Parliament shortly. This legislation will supersede the current regulation of collective investment schemes under existing regulations. The new provisions, finalised after extensive discussion with market participants, represent a major development of the present arrangements. The enhancements include: an expanded definition of the vehicles covered by regulation; enhanced powers for the Authority to intervene in the (rare) instances when problems emerge with a fund; revised classifications for funds - in particular the introduction of a new 'administered' class of fund; and the introduction of a new licensing and regulatory regime for persons conducting fund administration business in or from Bermuda. Market participants have been very positive in welcoming the development and introduction of the new legislation.

b) Bermuda Monetary Authority Amendment Act 2006

Provisions for the new BMA Amendment Act are in development and nearing completion. The amendments permit sub-delegation of certain matters by the BMA, and also make some technical revisions to fee categories and levels under certain acts related to the regulation of insurance, trust and investment businesses.

c) Insurance Amendment Act 2006 - Round II

Proposals for the next round of amendments to the Insurance Act 2006 have been discussed and the Authority will be circulating drafts of the proposed changes to industry before the end of the year. The proposed amendments will supplement changes made in the previously introduced Insurance Amendment Act that provided specifically for the creation of guidance by the Authority, as well as amending some fees.

(III) OTHER DEVELOPMENTS

a) Cheryl-Ann Lister, Chairman and CEO to Step Down

Cheryl-Ann Lister, Chairman and CEO of the Authority, will be formally stepping down from her dual role at the Authority, effective December 31, 2006. During her seven-year tenure, the Authority has experienced considerable growth and change, having increased its scope of responsibilities to include the regulation of all sectors within Bermuda's financial services market. As Chairman and CEO, Mrs. Lister has provided leadership for a number of fundamentally significant developments at the Authority. Those developments include: the 2000 KPMG review; the migration of insurance supervision from the Registrar of Companies to the Authority; the establishment of the Trust (Regulations of Trust Business) Act 2001, the initial IMF review of Bermuda's framework; the implementation of enhanced on-site programmes for trust businesses and insurance companies, and a significant growth in the Authority's staff complement to support its expanded responsibilities. The recruitment process for a new CEO is underway, in parallel with the selection procedure for a new Chairman. Mrs. Lister has agreed to continue to act in her current capacity if necessary while her successors are determined.

b) IAIS Captives Issues Paper

The Captives Issues Paper was presented and formally adopted at the International Association of Insurance Supervisors (IAIS) AGM that took place in Beijing, China in October. The next step will be the development of a Guidance Paper based on the current document, which Bermuda will actively participate in creating via its membership in various IAIS Committees.

c) Bermuda Contribution to IAIS Global Reinsurance Market Report 2006

This IAIS report covers trends in global reinsurance markets annually in seven countries, one of which is

Bermuda. The Authority liaised with 11 Bermuda reinsurance companies to provide aggregated data for the Report, representing the highest number of participating entities to date for this market. In addition to the various contributions provided as members of the survey committees producing the report, the Authority also produced two special papers on catastrophe bonds and sidecar arrangements which were included in the final report. The report has been published and is available on the IAIS website at www.iaisweb.org.

d) Seminars, Conferences and Publications

Jeremy Cox, Supervisor of Insurance and D. Munro Sutherland, Superintendent of Banking, Trust and Investments, attended the AGM of the IAIS in Beijing, China from October 16th - 21st.

Shelby Weldon, Deputy Director, Insurance and Shanna Lespere, Deputy Director, Insurance, attended the 18th Annual Executive Conference for Property-Casualty Industry in New York City from November 15th - 17th.

Cheryl-Ann Lister, Chairman & CEO was a guest speaker at the MarHedge Conference 2006 held at the Fairmont Southampton Resort on October 23rd.

D. Munro Sutherland was a panelist at the Caribbean Securities Regulators' Conference held in Nassau, Bahamas from October 25th - 27th.

Shanna Lespere attended the American Society of Health Care Risk Management conference held in San Diego, California on October 29th - November 1st.

Jeremy Cox was a guest speaker at the Bermuda Insurance 2006 Seminar hosted by Standard and Poors at the Fairmont Hamilton Princess on November 16th.

D. Munro Sutherland attended the IOSCO Technical Committee Conference in London, England from November 16th - 17th.

Pat Phillip-Bassett, Assistant Director, Policy, Research and Communications, and Oronde Walker, Senior Project Officer, Chairman's Office, attended the Overview of Financial Sector Issues and Analysis seminar sponsored by the World Bank, in Washington D.C. from October 16th - 20th.

Marcelo Ramella, Senior Research Officer attended the IAIS seminar on Reinsurance held in Basel, Switzerland from September 3rd - 8th.

Tina Woods, Principal, Banking, Trust and Investment (Institutions), attended the Comision Nacional de Valores, Brazil's financial regulator, 30th Anniversary conference in Rio de Janeiro, September 5th.

Fadwa Sahly, Principal, Banking, Trust and Investment (Risk Assessment & Compliance), attended the Financial Services Authority ARROW Risk Assessment Conference held in London from September 25th - 27th.

e) New Staff and Promotions

Martin McHugh has been promoted to Principal, Banking, Trust and Investments (Groups).

Kevin Anderson has joined the Policy Research & Communications department as Senior Analyst, Policy.

Melissa Morton has joined the Insurance department as Senior Analyst (Licensing and Authorisations).

Craig Swan has also joined the Insurance department as Principal (Compliance).

Candace Roach has joined the Insurance department as Senior Officer (Compliance).

Special Feature - Establishing an Enhanced Risk-Based Capital Model for Bermuda's Commercial Re-insurers

In the Regulatory Update published last June we reported that the Authority had taken initial steps to enhance the capital adequacy framework for Class 4 re-insurers by beginning consultations with industry in that regard. This proposal is part of the Authority's continuous review of Bermuda's supervisory framework for insurance, specifically related in this instance to minimum solvency requirements. The proposal concerns the development and introduction of an enhanced capital adequacy model, which the Authority would use as an additional tool to assist in the ongoing assessment of re-insurers' capital positions.

The current solvency requirements applied to Bermuda's Class 4 re-insurers were deemed to be "stringent" by the International Monetary Fund as part of its 2003 assessment of insurance and reinsurance jurisdictions. Basically, the requirements compare a fixed percentage of a re-insurer's overall net claims liabilities to a fixed percentage of its overall net premiums written, the larger of which becomes the re-insurer's minimum solvency margin, that is, the minimum amount of capital it must have at its disposal to cover its claims liabilities (subject to a \$100m minimum). This is a rigorous test designed to ensure re-insurers have an overall reserve of capital to guard against insolvency. The intention is now to enhance this approach to setting minimum solvency requirements in order to take into account the various levels of loss exposure or risk a re-insurer faces depending on the different types of business it is covering, and to take account of risks and volatility in other asset and liability classes.

Therefore, the new proposed risk-based capital adequacy model will apply capital charges tests to individual classes of business (premium and claims liability) based on the characteristics of premium and claims liabilities for that class of business rather than to the re-insurer's overall premium and claim liability balance. There will also be a specific capital charge for business that is exposed to natural catastrophes, and capital charges for other asset and liability classes.

The Authority is pursuing this approach for the proposed new model since it is consistent with the guiding principles of:

- Relevance - from a regulatory/supervisory perspective;
- Compatibility - within the context of international regulatory standards, and in line with the expectations of Bermuda's constituent re-insurers with global operations that expect to be regulated to a high standard; and
- Simplicity - this would be critical to the ultimate success of the model, since it needs to be understood and to be implemented with ease within the existing regulatory and supervisory framework.

The proposed risk-based capital model, or derivatives of this enhanced assessment tool, is also expected to support the Authority's regulatory and supervisory functions in a variety of ways in the future, including by:

- Providing an enhanced frame of reference for capital adequacy as part of the existing on-site review programme;
- Assessing new business applications quantitatively based on business financial projections and financial commitments;
- Assisting in the determination of regulatory/supervisory action for re-insurers where the Authority has regulatory concerns; and
- Facilitating analysis of the potential impact on capital adequacy in considering regulatory requests made by re-insurers.

The Authority is still conducting consultations with industry regarding the details of the proposed new model, including the means by which it would be incorporated within the regulatory framework. The intention is that in

the first instance the model will apply only to the Class 4 sector of re-insurers. The expectation is that rollout will be effective for the 2007 year-end.

In developing such an enhanced risk-based capital model the Authority continues to be guided by the principles of relevance, compatibility and simplicity. Relevance will be achieved through creating an enhanced and consistent tool to assist in the assessment of capital adequacy, a concept that is critical to the sound regulation of re/insurance entities. The Authority will ensure ongoing compatibility by benchmarking the model against major models used internationally, as part of our continuous monitoring of developing international trends in modeling techniques. Compatibility will also be critical in terms of the appropriateness of the model for the Bermuda market, which is being addressed via the consultative process with industry as the model is being developed. Finally, simplicity will be achieved by using effective and appropriate aspects of existing models already familiar to constituent re-insurers and the Authority itself as the basis for the enhanced new model proposed for Bermuda.

The Authority remains fully committed to taking the steps needed to preserve the effectiveness of Bermuda's supervisory framework for re-insurance, which ultimately supports Bermuda's leadership position in the global re-insurance market. The introduction of an enhanced risk-based capital model as part of further development of the capital adequacy regime for Bermuda's re-insurance businesses is one way in which it is continuing to demonstrate this commitment.

STATISTICAL ANNEXE

BERMUDA MONEY SUPPLY

(BD\$ millions)	2005-Q1	2005-Q2	2005-Q3	2005-Q4	2006-Q1	2006-Q2
Notes & Coins in Circulation*	93	99	98	114	99	106
Deposit liabilities:						
Banks and Deposit Companies (unconsolidated)	3,579	3,562	3,510	3,362	3,418	3,481
	3,672	3,662	3,609	3,476	3,517	3,588
Less: Cash at Banks and Deposit Companies	26	28	25	40	24	31
BD\$ Money Supply	3,646	3,634	3,583	3,437	3,493	3,557
% Growth on Previous Period	0.43%	-0.33%	-1.39%	-4.10%	1.64%	1.84%
% Growth Year on Year	5.63%	2.15%	-0.79%	-5.34%	-4.20%	-2.11%

* 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.

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

(BD\$ Millions)	2005-Q1	2005-Q2	2005-Q3	2005-Q4	2006-Q1	2006-Q2
Deposit Liabilities	3,579	3,562	3,510	3,362	3,418	3,481
Less:						
Loans, Advances and Mortgages	(2,942)	(3,079)	(3,281)	(3,368)	(3,438)	(3,589)
Surplus deposits	637	484	230	(6)	(20)	(107)
Percentage of Deposit Liabilities Lent	82.2%	86.4%	93.5%	100.2%	100.6%	103.1%

§ Following recent amalgamations within the sector, separate data for the deposit companies are no longer published.

COMBINED BANKS AND DEPOSIT COMPANIES FOREIGN CURRENCY
(Consolidated)

(BD\$ millions)	2005 - Q1	2005 - Q2	2005 - Q3	2005 - Q4	2006 - Q1	2006 - Q2
Total Foreign Currency Assets	19,211	15,621	16,109	18,570	18,269	18,617
Less: Other Assets	285	265	285	392	516	495
Less: Foreign Currency Loans to Residents	917	995	1,086	1,154	1,109	1,074
Net Foreign Currency Assets	18,009	14,361	14,739	17,024	16,644	17,048
Foreign Currency Liabilities	17,253	13,517	14,212	16,748	16,302	16,882
Add: BD\$ Deposits of Non-Residents	117	124	117	117	120	134
Net Foreign Currency Liabilities	17,370	13,641	14,328	16,865	16,421	17,016
Net Foreign Currency Position (consolidated)	640	720	411	159	223	32

Totals may not add due to rounding

COMPANIES PARTNERSHIPS & PERMITS STATISTICS
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**APPLICATIONS APPROVED
SUMMARY Q2-2006**

	2005-Q2	2005-Q3	2005-Q4	2006-Q1	2006-Q2
Exempted Companies (Bermuda companies exempted from the 60% Bermudian ownership requirement)	230	249	279	282	244
Exempted Partnerships (partnerships established in Bermuda to carry on business in or from within Bermuda)	32	22	36	25	72
Overseas Partnerships (overseas partnerships applying for permits to carry on business in or from within Bermuda)	0	1	8	2	1
Overseas Permit Companies (overseas companies applying for permits to carry on business in or from within Bermuda)	7	4	16	3	5
Unit Trusts	14	10	46	12	19
Continuation Companies (companies from other jurisdictions continuing into Bermuda as exempted companies)	5	7	13	6	10
Unlimited Liability Companies	0	0	0	0	1
Local Companies	56	50	45	56	64
Total Applications Approved *	344	343	443	386	416

* Quarterly Numbers are amended to reflect more up-to-date consent information

COLLECTIVE INVESTMENT SCHEMES STATISTICS

	2005-Q1	2005-Q2	2005-Q3	2005-Q4	2006-Q1	2006-Q2
Mutual Funds	836	849	836	846	850	869
Umbrella Funds	64	67	60	62	62	62
Sub-Funds	378	405	328	315	293	284
Segregated Account Companies	38	45	49	55	61	64
Segregated Accounts	177	247	290	331	394	394
Total	1,493	1,613	1,563	1,609	1,660	1,673
Unit Trusts	100	105	101	105	107	108
Umbrella Trusts	74	81	71	114	122	139
Sub-Trusts	180	227	211	215	232	232
Total	354	413	383	434	461	479
TOTAL PORTFOLIOS	1,847	2,026	1,946	2,043	2,121	2,152
TOTAL NUMBER OF SCHEMES	1,112	1,147	1,117	1,182	1,202	1,242
TOTAL NET ASSET VALUE (IN BILLIONS)	\$166.50	\$178.58	\$180.01	\$187.53	\$209.07	\$216.53

Note: Data reported for the periods after Q4 2005 include schemes that have been granted exemption pursuant to Regulation 3A of the Bermuda Monetary Authority (Collective Investment Scheme Classification) Regulations 1998.

ADDITIONS TO THE INSURANCE REGISTER

	2005	2005	2005	2005	2006	2006
	Q1	Q2	Q3	Q4	Q1	Q2
Class 1	2	3	3	4	3	6
Single-parent captive insuring only risks of its owners or affiliates of the owners						
Class 2	3	3	3	2	2	1
(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	6	7	3	15	8	12
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	0	0	11	0	1
Insurers and reinsurers capitalised at a minimum of \$100 million underwriting direct excess liability and/or property catastrophe reinsurance risk						
Long-Term Insurers	3	3	1	2	4	0
Insurers writing long-term (or life) business						
Composites	0	0	0	1	0	0
Insurers writing combination of long-term (or life) business and Class 1, 2, 3 or 4 business						
Total additions during quarter	14	16	10	35	17	20

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