

Quarterly Banking Digest

Q2 2010

HIGHLIGHTS

- The aggregate risk asset ratio of the Bermuda banking sector increased from 20.2% in the previous quarter to 21.0%.
- The sector returned to profitability during the quarter. The return on equity (ROE) increased from -21.7% in the first quarter to 8.8% while the return on assets (ROA) increased from -2.5% to 1.1%.
- Non-performing loans increased slightly during the quarter, but performing loans remained at about 97% of total loans.
- Total assets increased for the fourth consecutive quarter, driven by an increase in customer deposits of 3.7%. Within this total, foreign currency denominated customer deposits increased by 5.1% during the quarter.
- Securities issued by banks were 73.2% of the sector's total investment portfolio during the quarter, down from 80.2% in the first quarter. The shift was mainly to sovereign investments which increased from 3.6% to 9.6%.

Selected Indicators

Table I below is a summary of selected indicators, including capital, earnings and asset quality for Bermuda's banks.

Table I: Selected Indicators (Part I)

(Ratios in percentage)	2010		2009		
	Jun	Mar	Dec	Sep	Jun
Capital Position					
Risk Asset Ratio	21.0	20.2	15.5	17.2	17.7
Asset to Regulatory Capital Multiple	9.7	9.9	12.1	10.9	10.7
Equity to Total Assets	12.5	12.2	10.7	12.0	12.1
Profitability					
Interest margin to interest income	82.6	81.4	80.0	79.1	76.6
Return on assets	1.1	-2.5	-3.1	0.9	0.8
Return on equity	8.8	-21.7	-27.3	7.9	7.1

Table I: Selected Indicators (Part II)

(Ratios in percentages)	2010		2009		
	Jun	Mar	Dec	Sep	Jun
Loan Book					
Provisions to Non-Performing Loans (NPLs)	53.9	62.3	56.6	17.3	17.3
NPLs to total loans	3.4	2.9	3.1	3.2	3.1
NPLs to capital	12.5	10.9	14.5	13.6	12.4
Other					
BD\$ money supply growth	-0.9	-2.4	-0.4	1.0	0.3
Asset growth rate	3.9	1.4	1.6	-3.0	2.2
Customer deposits growth rate	3.7	-0.1	3.6	-2.8	1.6
FX denominated deposits to total deposits	80.9	79.8	79.5	78.6	79.5
Loans to deposits	45.7	45.7	45.2	46.6	44.9

All figures in this report are reported at the consolidated level unless otherwise stated.

BALANCE SHEET

Aggregate Balance Sheet

Table II below provides a balance sheet summary showing recent trends in the sector.

Table II: Aggregate Balance Sheet Condition

(BD\$ billions)	2010		2009			Change (%)	
	Jun	Mar	Dec	Sep	Jun	QoQ	YoY
Assets							
Cash	0.1	0.1	0.1	0.1	0.1	12.7	9.9
Deposits	6.6	6.3	5.7	5.2	5.4	5.5	23.6
Loans & Advances	8.7	8.4	8.3	8.3	8.2	3.7	6.0
Investments	6.2	6.1	6.5	6.6	7.2	1.8	-12.9
Other Assets	1.1	1.0	1.1	1.1	1.1	7.3	-0.1
Total Assets	22.8	21.9	21.6	21.3	21.9	3.9	3.9
Liabilities							
Savings Deposits	4.6	4.7	4.5	4.1	4.2	-3.6	10.3
Demand Deposits	8.0	7.8	8.1	7.6	7.7	3.5	4.7
Time Deposits	6.5	5.9	5.9	6.1	6.5	9.8	0.0
Total Deposits	19.1	18.4	18.5	17.8	18.3	3.7	4.3
Other Liabilities	0.5	0.5	0.6	0.6	0.7	0.8	-21.0
Total Liabilities	19.7	19.0	19.1	18.4	19.0	3.7	3.7
Equity and Subordinated Debt	3.1	3.0	2.6	2.8	2.9	5.2	6.6
Total Liabilities and Equity	22.8	21.9	21.6	21.3	21.9	3.9	3.9

Totals may not add due to rounding

- Total assets increased by 3.9% during the second quarter.
- Within this total, loans and advances rose by 3.7% and by 6% year-on-year.
- Total customer deposits increased during the quarter by 3.7% and by 4.3% year-on-year. The most significant increase was in time deposits, which rose by 9.8%, driven primarily by a 13.5% rise in foreign currency-denominated time deposits.
- Deposits held with other financial institutions increased by 5.5% during the quarter and 23.6% year-on-year. The annual increase reflects a re-allocation of assets away from investments.

Summary of Balance Sheet Ratios

Table III below is a summary of balance sheet ratios measuring asset quality and capital.

Table III: Summary Balance Sheet Ratios

(Ratios in percentages)	2010		2009		
	Jun	Mar	Dec	Sep	Jun
Asset Allocation					
Investments	27.4	28.0	29.9	31.0	32.7
Loans	38.3	38.4	38.6	39.0	37.5
Deposits	29.1	28.7	26.1	24.4	24.5
Deposits Allocation					
Savings	23.9	25.8	24.2	23.0	22.6
Demand	42.0	42.1	43.9	42.9	41.9
Time	34.0	32.1	31.9	34.1	35.5
Capital Position					
Risk Asset Ratio	21.0	20.2	15.5	17.2	17.7
Equity to Total Assets	12.5	12.2	10.7	12.0	12.1
Asset to Regulatory Capital Multiple	9.7	9.9	12.1	10.9	10.7
Loan Book					
NPLs to total loans	3.4	2.9	3.1	3.2	3.1
Provisions to NPLs	53.9	62.3	56.6	17.3	17.3
Provisions to total loans	1.8	1.8	1.8	0.6	0.5

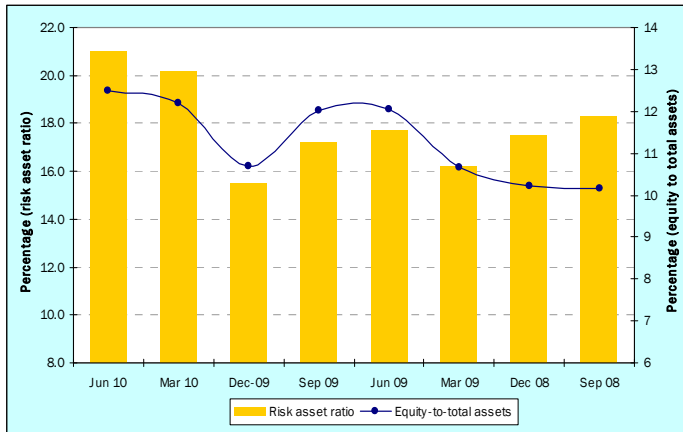
Totals may not add due to rounding

- The proportion of deposits with other financial institutions to total assets increased from 28.7% in the first quarter to 29.1% while the proportion of assets allocated to investments decreased from 28.0% to 27.4%.
- The sector's risk asset ratio increased from 20.2% to 21.0%.
- The proportion of non-performing loans to total loans increased during the quarter from 2.9% to 3.4%. The proportion of provisions to NPLs decreased quarter-on-quarter from 62.3% to 53.9%.

Capital Adequacy

Chart I below shows the movement in the risk asset ratio and the ratio of equity to total assets for the last eight quarters.

Chart I: Risk Asset Ratios and Proportion of Equity to Total Assets

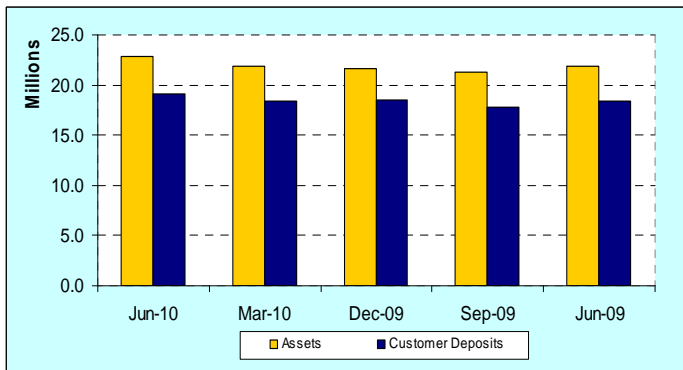


- The aggregate risk asset ratio rose slightly to 21.0%, showing continued improvement in capital levels for the sector.
- Equity to total assets increased quarter-on-quarter from 12.2% to 12.5%.

Total Assets and Customer Deposits

Chart II below shows changes in assets and customer deposits for the last five quarters.

Chart II: Assets and Customer Deposits



- Total assets for the sector increased during the quarter from BD\$21.9 billion to BD\$22.8 billion.
- Total customer deposit liabilities increased from BD\$18.4 billion to BD\$19.1 billion. The increase is attributable to an increase in time deposits of 9.8% and demand deposits of 3.5% respectively, which more than offset a decrease in savings deposits of 3.6%.

Loan Book

Table IV below is a summary of ratios measuring the composition and quality of the loan book for the last five quarters.

Table IV: Quality of the Loan Book

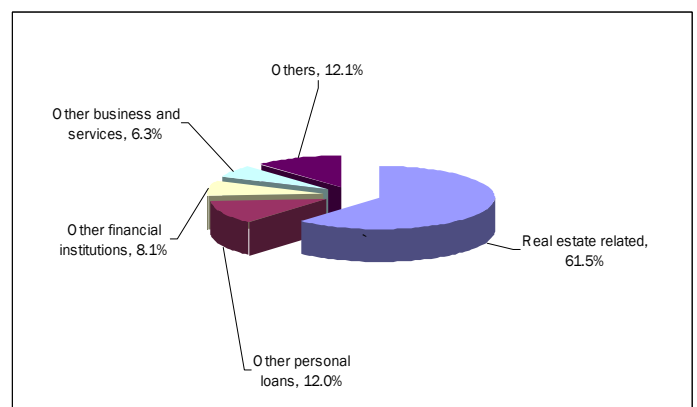
(Ratios in percentages)	2010		2009		
	Jun	Mar	Dec	Sep	Jun
Loans and advances quarter-over-quarter growth rate	3.7	1.0	0.4	0.9	5.5
Mortgages on residential property to total loans	51.1	52.5	52.3	51.2	49.4
BD\$ denominated loans to total loans	60.1	60.1	60.1	60.8	60.3
Non-Performing Loans					
NPLs to total loans	3.4	2.9	3.1	3.2	3.1
NPLs to capital	12.5	10.9	14.5	13.6	12.4
Net charge-offs to loans	0.39	0.29	4.94	0.14	0.16
Provisioning Practices					
Provisions to NPLs	53.9	62.3	56.6	17.3	17.3
Provisions to total loans	1.8	1.8	1.8	0.6	0.5

- The proportion of performing loans to total loans fell during the quarter, but remained relatively high at 96.6%.
- The proportion of provisions to non-performing loans decreased from 62.3% to 53.9% reflecting a faster rise in NPLs of 21.6% as compared to an increase in provisions of 5.1%.

Sectoral Distribution of Loans

Chart III below shows the sectoral distribution of loans as at 30th June 2010.

Chart III: Sectoral Distribution of Loans and Advances

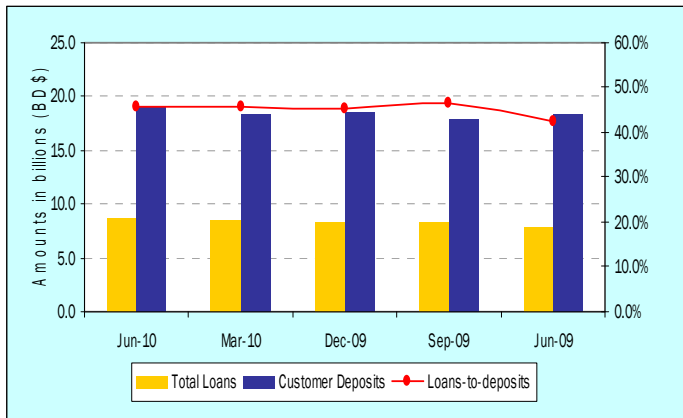


- The loan book for the sector continues to be dominated by real estate related exposure, reported at 61.5% of total loans and advances in the second quarter.

Loans-to-Deposits Ratios

Chart IV below shows the movement in total loans and customer deposits, and the ratio of total loans to customer deposits for the last five quarters.

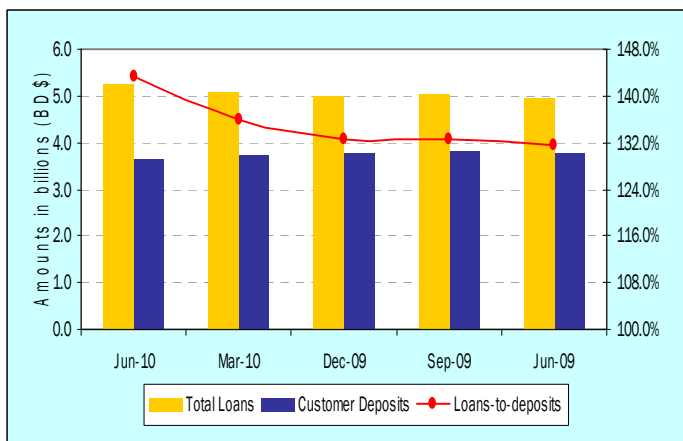
Chart IV: Total Loans and Customer Deposits



- The loans-to-deposits ratio remained relatively stable during the quarter.

Chart V below shows the movement in Bermuda dollar-denominated loans and customer deposits, and the ratio of Bermuda dollar-denominated loans to customer deposits for the last five quarters.

Chart V: Bermuda Dollar Loans and Customer Deposits

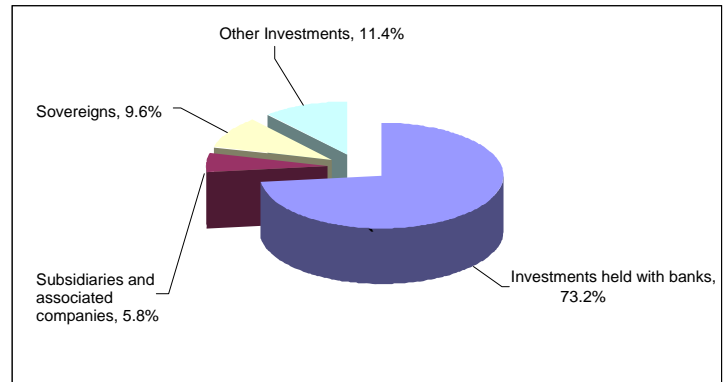


- The Bermuda dollar loans-to-deposits ratio increased during the quarter from 136.0% in Q1 2010 to 143.3%, up from 131.9% in Q2 2009. This reflects a 3.6% increase in Bermuda dollar-denominated loans and advances during the quarter, as compared to a 1.7% decrease in Bermuda dollar-denominated customer deposits.

Investment Book

Chart VI below shows the structure of the investment book as at 30th June 2010.

Chart VI: Structure of the Investment Book



- Within the 'other investments' category is a relatively small exposure to equity tranches of securitisation instruments comprising about 0.1% of the total investment portfolio in Q2 2010.
- Securities issued by banks comprised 73.2% of the total investment portfolio, down from 80.2% in the first quarter. The decline reflects a shift to sovereign investments which now make up 9.6% of the investment book compared to 3.6% in the first quarter.

Foreign Currency Position

Table V below shows the foreign currency position for the sector for the last five quarters.

Table V: Foreign Currency Position

(Ratios in percentage)	2010		2009		
	Jun	Mar	Dec	Sep	Jun
FX denominated assets to total assets	74.0	74.1	73.8	73.2	74.8
FX denominated loans to total loans	39.9	39.9	39.9	39.2	39.7
FX denominated deposits to total deposits	80.9	79.8	79.5	78.6	79.5
Changes in FX assets	3.8	1.8	2.5	-5.0	2.6
Changes in FX loans and advances	3.8	0.8	2.3	-0.4	12.7
Changes in FX customer deposits	5.1	0.2	4.7	-3.8	2.2

- Foreign currency-denominated customer deposits increased by 5.1% during the quarter. Within the total, foreign currency demand and time deposits rose by 4.3% and 13.5% respectively, while there was a decrease in foreign currency-denominated savings deposits of 4.8%.

- At the end of the second quarter, 63.5% of total foreign currency assets of BD\$16.8 billion were denominated in US dollars. US dollar assets made up 47.0% of total assets for the sector.

Bermuda Dollar-Denominated Balance Sheet

Table VI below shows the Bermuda dollar balance sheet for the sector for the last five quarters.

Table VI: Bermuda Dollar Balance Sheet Position

(BD\$ billions)	2010		2009			Change (%)	
	Jun	Mar	Dec	Sep	Jun	QoQ	YoY
Loans and Advances	5.2	5.1	5.0	5.1	5.0	3.6	5.6
Total Assets	5.9	5.7	5.7	5.7	5.5	4.1	6.9
Deposit Liabilities	3.7	3.7	3.8	3.8	3.8	-1.7	-2.8
Equity and Subordinated Debt	2.1	1.6	1.7	1.9	2.0	28.4	4.0

- Total Bermuda dollar assets increased by 4.1% during the quarter, and by 6.9% year-on-year. The growth in Bermuda dollar assets is attributed to an increase in Bermuda dollar-denominated equity.

PROFIT AND LOSS

Table VII below is a summary of profitability ratios for the sector for the last five quarters.

Table VII: Summary of Profitability Ratios

(Ratios in percentage)	2010		2009		
	Jun	Mar*	Dec	Sep	Jun
Interest margin to interest income	82.6	81.4	80.0	79.1	76.6
Interest margin to total income	45.2	226.2	113.6	50.4	49.5
Non-interest expenses to total income	68.4	365.0	167.7	72.1	75.3
Personnel expenses to non-interest expenses	57.2	60.0	57.4	58.1	59.6
Return on assets (ROA)	1.1	-2.5	-3.1	0.9	0.8
Adjusted ROA	1.1	-2.5	-3.3	0.9	0.8
Return on equity (ROE)	8.8	-21.7	-27.3	7.9	7.1
Adjusted ROE	8.8	-21.7	-27.3	7.9	7.1
Interest income to earning assets	2.5	2.5	2.7	2.8	2.8
Interest expenses to customer deposits	0.5	0.5	0.6	0.7	0.7

* Includes the impact of a substantial decrease in book value of investments reported by one institution under other banking income. This had the impact of decreasing the total income.

Margin Analysis

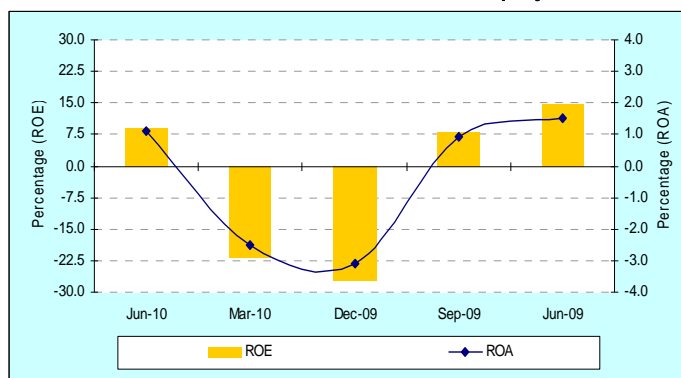
- The interest margin to interest income increased in the second quarter to 82.6% from 81.4% in the first quarter and 76.6% in Q2 2009. The quarterly increase can be attributed to a decrease in interest expenses at 4.5% as compared to a 2.1% increase in interest income.

- The significant quarter-on-quarter decreases in the proportion of interest margin to total income and non-interest expenses to total income are a result of the recovery from the low level of total income generated in the prior quarter. In the first quarter, total income was significantly impacted by a decrease in the book value of investments arising from the restructuring of the investment portfolio of one institution.

Profitability Ratios

Chart VII below shows the trend in the return on assets and return on equity over the last five quarters.

Chart VII: Return on Assets and Return on Equity

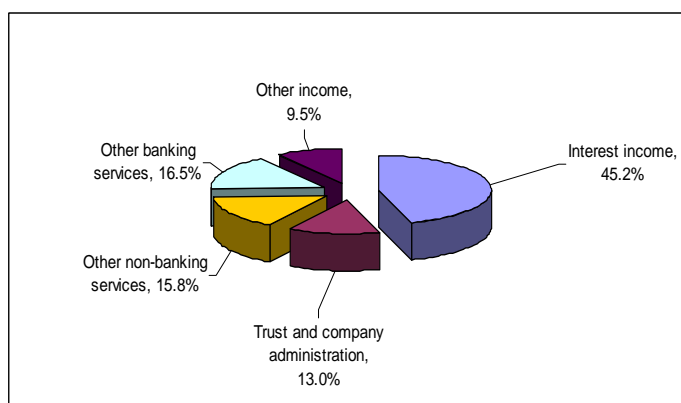


- ROE increased from -21.7% in the first quarter to 8.8% while ROA increased from -2.5% to 1.1%. These movements reflect a return to profitability following the recognition of significant losses in the prior period confined to one institution.

Distribution of Income Sources

Chart VIII below shows the distribution of income sources for the year ended 30th June 2010.

Chart VIII: Distribution of Income Sources

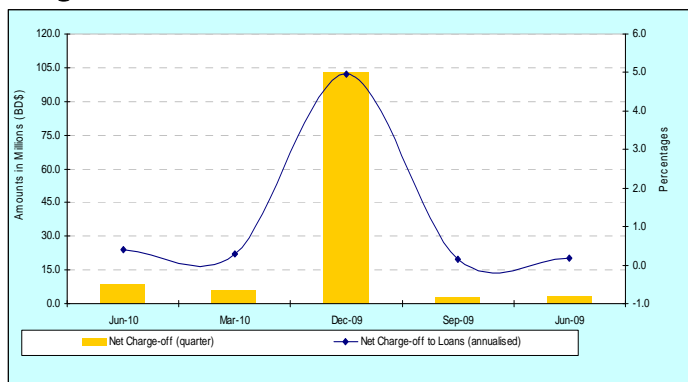


- Interest income contributed 45.2% of total income. Income from non-banking services made up 28.8% of total income.

Net Profit and Loss Charge for Loan Provisions

Chart IX below shows the trend in the net charge-offs for bad and doubtful loans and net charge-off as a proportion of total loans over the last five quarters.

Chart IX: Net Annualised Charge-Offs and Proportion of Charge-Offs To Loans



- The net profit and loss charge for bad debt (provisions) increased from BD\$6 million in the first quarter to BD\$8.57 million.
- The annualised proportion of net charge-off to total loans increased quarter-on-quarter from 0.3% in Q1 2010 to 0.4% in Q2 2010.

Table VIII below shows the trend in the overall money supply for Bermuda for the last five quarters.

Table VIII: Bermuda Money Supply (Unconsolidated)

(BD\$ millions)	2010		2009		
	Jun	Mar	Dec	Sep	Jun
Notes and coins in circulation*	134	127	137	123	127
Deposit liabilities	3,719	3,748	3,840	3,858	3,816
Banks and deposit companies	3,853	3,875	3,977	3,981	3,943
Less: Cash at banks and deposit companies	73	61	70	60	60
Bermuda dollar money supply	3,780	3,814	3,907	3,921	3,883
% Growth on previous period	-0.89	-2.37	-0.36	0.98	0.33
% Growth year-on-year	-2.64	-1.44	0.18	0.43	0.44

* The table above includes the supply of Bermuda dollars only.

- The Bermuda money supply decreased by 0.9% during the quarter and by 2.6% year-on-year. This is attributed to decreasing Bermuda Dollar deposit liabilities coupled with elevated levels of cash on hand at quarter end.

SELECT INTERNATIONAL DEVELOPMENTS

The section below highlights international developments that occurred during the quarter, as they contribute to shaping international regulatory and financial trends. The section does not reflect the views of the Bermuda Monetary Authority.

The Basel Committee on Banking Supervision at its 14th-15th July meeting reviewed the design and overall calibration of its capital and liquidity frameworks. Based on this review, the Committee developed concrete recommendations for completing its package of regulatory reforms. The Committee also reviewed proposals for the role of "gone concern" contingent capital in the regulatory capital framework and will issue shortly a proposal for consultation.

The Committee also issued for consultation a fully-fleshed out countercyclical capital buffer proposal. The countercyclical buffer would be imposed when, in the view of national authorities, excess aggregate credit growth is judged to be associated with a build-up of system-wide risk.

The Group of Governors and Heads of Supervision reach broad agreement on Basel Committee capital and liquidity reform package. The agreement includes the definition of capital, the treatment of counterparty credit risk, the leverage ratio, and the global liquidity standard. The Committee will finalise the regulatory buffers before the end of this year. The Governors and Heads of Supervision also agreed to finalise the calibration and phase-in arrangements at their meeting in September.

The Financial Stability Board (FSB) and Basel Committee on Banking Supervision (BCBS) publishes reports prepared as inputs to the calibration of the new bank capital and liquidity standards and to inform the transition arrangements for implementation of the new standards. The two reports are "An assessment of the long-term economic impact of stronger capital and liquidity requirements", prepared by the Basel Committee, and "Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements", the interim report of the joint FSB-BCBS Macroeconomic Assessment Group (MAG). Together, the two reports provide an assessment of both the net economic impact of stronger capital and liquidity reforms once implementation is complete and the macroeconomic implications during the transition to full implementation.

The Bank for International Settlements released its working paper No. 315, "The determinants of cross-border bank flows to emerging markets: new empirical evidence on the spread of financial crises". The paper highlights the nature of spillover effects in the bank lending flows from advanced to emerging market economies, and identifies specific channels through which such effects occur.

The Financial Stability Board ("FSB") released a report, "Reducing the moral hazard posed by systemically important financial institutions". The report looks at the "overall direction of work on the development of a policy framework for reducing the moral hazard risks posed by systemically important financial institutions (SIFIs)." The FSB are planning to build principles for policy recommendations to address moral hazard.

Glossary

Adjusted return on assets is the return on assets computed using net income excluding extraordinary items.

Adjusted return on equity is the return on equity computed using net income excluding extraordinary items.

Earning assets includes deposits with other financial institutions, loans, advances and leases, and investments.

Equity refers to the shareholders' equity.

Fees and commissions consist of net income from banking fees, charges and commissions, investment management fees, trust and company administration fees, trustee and custodian fees, and fund management fees.

Foreign currency is any currency other than the Bermuda dollar.

General provisions are provisions not attributed to specific assets but to the amount of losses that experience suggests may be in a portfolio of loans.

Interest expenses to customer deposits is computed by dividing the annualised interest paid and payable by the average total customer deposit liabilities.

Interest income to earning assets is computed by dividing the annualised interest received and receivable by the average total earning assets.

Interest income includes interest received and receivable, and consists of interest from deposits with financial institutions, government securities, loans and other interest earning assets.

Interest margin is calculated as interest received or receivable less interest paid or payable.

Leverage is calculated as shareholders equity divided by total assets.

Mortgages refer to financing for land and buildings for purchasing real estate estate/residential property.

Net charge-offs for bad and doubtful loans is the sum of general and specific profit and loss charge for doubtful debts and transfers made to suspended interest account (net of recoveries).

Net income is derived by netting off provision for taxation from gross profit, and takes into account extraordinary items.

Non-interest income includes all other income received by the bank. Included are fees and commissions from provision of services, gains and losses on financial instruments, and other income.

Non-interest expenses cover all expenses other than interest expenses, including fees and commissions.

Non-Performing Loans (NPLs) consist of those loans classified as substandard, doubtful and loss as per the BMA guidance on completion of the prudential information return for banks. A loan is classified as substandard when the delay in repayment is between 31 and 90 days, as doubtful when the delay is between 91 and 180 days and as loss when the delay exceeds 180 days.

Other income consists of increase or decrease in book value of investments, other non-banking services income, profit or loss on fixed assets and any other income that cannot be classified into any other specific income line item.

Other operating expenses consist of services by external service providers and other operating expenses.

Provisions include both specific and general provisions.

Real estate is used to refer to lending to real estate operators, and owners and lessors of real property, as well as buyers, sellers, developers, agents and brokers.

Regulatory capital is the total (net) capital as provided by the banks in their quarterly prudential information returns. It is the sum of Tier 1 and Tier 2 capital less total capital deductions.

Regulatory capital to total assets is derived by dividing the regulatory capital by the total assets as provided in the prudential information returns.

Return on assets is calculated by dividing the net income by the average value of total assets over the same period. The average assets is obtained by averaging the total assets at the beginning and at the end of the quarter.

Return on equity is calculated by dividing net income by the average value of shareholders' equity over the same period. The average shareholders' equity is obtained by averaging the shareholders' equity at the beginning and at the end of the quarter.

Risk Asset Ratio is calculated as total (net) regulatory capital divided by total risk weighted assets.

Risk weighted assets (RWA) refers to a concept developed by the Basel Committee on Banking Supervision (BCBS) for the capital adequacy ratio. Assets are weighted by factors representing their riskiness and potential for default.

Specific provisions are the outstanding amount of provisions made against the value of individual loans, collectively assessed groups of loans and loans to other deposit takers.

Tier 1 capital consists of ordinary shares, perpetual non-cumulative preference shares, reserves verified by the auditors, current year's losses and minority interest (in Tier 1) adjusted for goodwill and other intangibles, and securitisation but before capital deductions.

Total income is the sum of net interest income and non-interest income.

Total loans include loans, advances, bills and finance leases.

Total risk weighted assets (RWA) is the sum of total credit risk weighted assets, total operational risk adjusted RWA and the total market risk adjusted RWA.

Note: Refer to the Guidance on Completion of the Prudential Information Return for Banks for a detailed description of the individual components of specific line items.

All numbers have been derived from the Prudential Information Returns submitted to the Authority by individual banks.
