

Quarterly Banking Digest

Q3 2010

HIGHLIGHTS

- The aggregate risk asset ratio for the Bermuda banking sector increased for the third consecutive quarter to stand at 25.0% at end-September, 2010. The latest quarterly increase was driven by a 21.2% increase in regulatory capital, mainly reflecting a group re-structuring by one bank. There was also an improvement in the proportion of equity to total assets (the leverage ratio), up from 12.5% in Q2 2010 to 13.1%.
- The sector's profitability decreased during the quarter, the return on equity (ROE) falling from 8.8% in Q2 to 6.1% while the return on assets (ROA) fell from 1.1% to 0.8 %.
- The quarter saw a sharp fall in the ratio of provisions to non-performing loans from 53.9% in Q2 2010 to 36.1%. Performing loans remained high at about 96% of total loans.
- Total assets and customer deposits decreased by 2.2% and 2.6% respectively. The decrease in customer deposits was mainly driven by a 10.3% decline in foreign currency-denominated customer deposits during the quarter.
- Investments held with sovereign entities increased from 9.6% in the second quarter to 19.8%, mainly as a result of additional investments in high-quality government-sponsored instruments.

Selected Indicators

Table I below is a summary of selected indicators, including capital, earnings and asset quality.

Table I: Selected Indicators (Part I)

(Ratios in percentages)	2010			2009	
	Sep	Jun	Mar	Dec	Sep
Capital Position					
Risk Asset Ratio	25.0	21.0	20.2	15.5	17.2
Asset to Regulatory Capital Multiple	7.8	9.7	9.9	12.1	10.9
Equity to Total Assets	13.1	12.5	12.2	10.7	12.0
Profitability					
Interest margin to interest income	83.5	82.6	81.4	80.0	79.1
Return on assets	0.8	1.1	-2.5	-3.1	0.9
Return on equity	6.1	8.8	-21.7	-27.3	7.9

Table I: Selected Indicators (Part II)

(Ratios in percentages)	2010			2009	
	Sep	Jun	Mar	Dec	Sep
Loan Book					
Provisions to Non-Performing Loans (NPLs)	36.1	53.9	62.3	56.6	17.3
NPLs to total loans	3.7	3.4	2.9	3.1	3.2
NPLs to capital	11.1	12.5	10.9	14.5	13.6
Other					
BD\$ money supply growth	-0.4	-0.9	-2.4	-0.4	1.0
Asset growth rate	-2.2	3.9	1.4	1.6	-3.0
Customer deposits growth rate	-2.6	3.7	-0.1	3.6	-2.8
FX denominated deposits to total deposits	80.4	80.9	79.8	79.5	78.6
Loans to deposits	45.2	45.7	45.7	45.2	46.6

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 (%)	
	Sep	Jun	Mar	Dec	Sep	QoQ	YoY	
Assets								
Cash	0.1	0.1	0.1	0.1	0.1	-12.0	-3.5	
Deposits	6.4	6.6	6.3	5.7	5.2	-3.0	24.1	
Loans & Advances	8.4	8.7	8.4	8.3	8.3	-3.5	1.4	
Investments	6.3	6.2	6.1	6.5	6.6	0.2	-5.2	
Other Assets	1.1	1.1	1.0	1.1	1.1	-0.1	-2.6	
Total Assets	22.3	22.8	21.9	21.6	21.3	-2.2	4.7	
Liabilities								
Savings Deposits	4.8	4.6	4.7	4.5	4.1	4.6	16.7	
Demand Deposits	7.3	8.0	7.8	8.1	7.6	-9.4	-4.8	
Time Deposits	6.6	6.5	5.9	5.9	6.1	0.8	8.0	
Total Deposits	18.6	19.1	18.4	18.5	17.8	-2.6	4.5	
Other Liabilities	0.4	0.5	0.5	0.6	0.6	-19.1	-29.8	
Total Liabilities	19.1	19.7	19.0	19.1	18.4	-3.0	3.4	
Equity and Subordinated Debt	3.2	3.1	3.0	2.6	2.8	2.9	12.8	
Total Liabilities and Equity	22.3	22.8	21.9	21.6	21.3	-2.2	4.7	

Totals may not add due to rounding

- Total assets decreased by 2.2% during the third quarter.
- Within this total, loans and advances decreased by 3.5% but increased by 1.4% year-on-year.
- Deposits held with other financial institutions decreased by 3.0% during the quarter but increased by 24.1% year-on-year, mainly as a result of a re-allocation of assets away from the investment book into additional placements.
- Total customer deposits decreased during the quarter by 2.6% but rose by 4.5% year-on-year. The most significant decrease during the quarter was in demand deposits, down by 9.4%, driven primarily by a 19.4% decrease in US dollar-denominated demand deposits.

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	
	Sep	Jun	Mar	Dec	Sep
Asset Allocation					
Investments	28.1	27.4	28.0	29.9	31.0
Loans	37.8	38.3	38.4	38.6	39.0
Deposits	28.9	29.1	28.7	26.1	24.4
Deposits Allocation					
Savings	25.7	23.9	25.8	24.2	23.0
Demand	39.1	42.0	42.1	43.9	42.9
Time	35.2	34.0	32.1	31.9	34.1
Capital Position					
Risk Asset Ratio	25.0	21.0	20.2	15.5	17.2
Equity to Total Assets	13.1	12.5	12.2	10.7	12.0
Asset to Regulatory Capital Multiple	7.8	9.7	9.9	12.1	10.9
Loan Book					
NPLs to total loans	3.7	3.4	2.9	3.1	3.2
Provisions to NPLs	36.1	53.9	62.3	56.6	17.3
Provisions to total loans	1.3	1.8	1.8	1.8	0.6

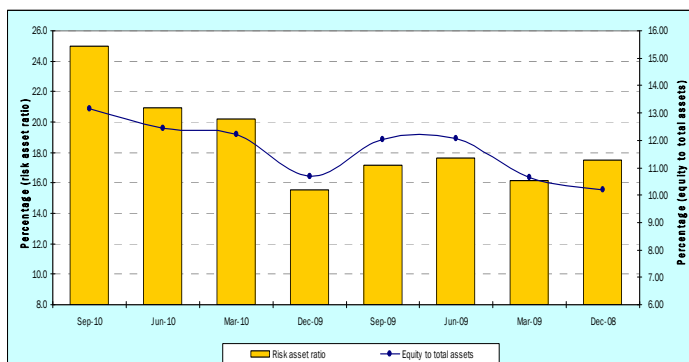
Totals may not add due to rounding

- The proportion of assets allocated to investments increased from 27.4% in the second quarter to 28.1%.
- The sector's risk asset ratio increased from 21.0% to 25.0%, driven mainly by a 21.2% increase in reported regulatory capital.
- The leverage ratio improved for the third consecutive quarter rising from 12.5% in Q2 2010 to 13.1%.
- The proportion of non-performing loans to total loans increased during the quarter from 3.4% to 3.7%.
- The ratio of provisions to NPLs fell from 53.9% to 36.1%. The decrease was driven by a significant fall in specific provisions mainly attributable to one institution.

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

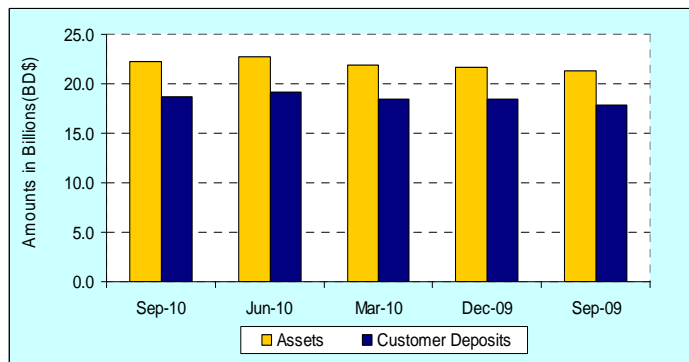


- The aggregate risk asset ratio rose to 25.0%, showing continued improvement in capital levels for the sector for the third consecutive quarter.
- Equity to total assets increased quarter-on-quarter from 12.5% to 13.1%.

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 decreased during the quarter from BD\$22.8 billion to BD\$22.3 billion.
- Total customer deposit liabilities decreased from BD\$19.1 billion to BD\$18.6 billion. The decrease was attributable to a fall in demand deposits of 9.4% which more than offset an increase in savings deposits of 4.6% and a marginal increase in time deposits of 0.8%.

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

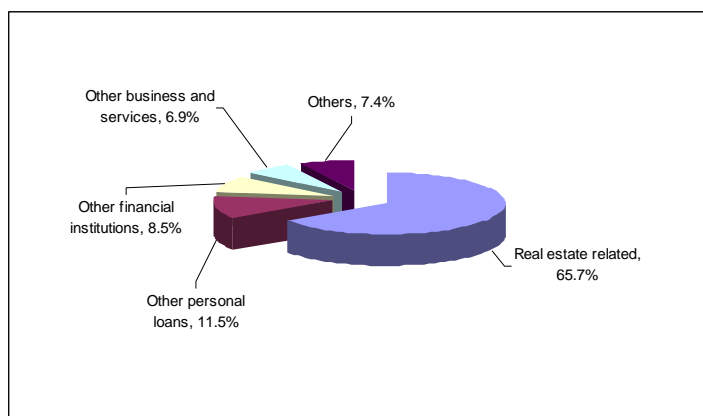
(Ratios in percentages)	2010			2009	
	Sep	Jun	Mar	Dec	Sep
Loans and advances quarter-over-quarter growth rate	-3.5	3.7	1.0	0.4	0.9
Mortgages on residential property to total loans	53.3	51.1	52.5	52.3	51.2
BD\$ denominated loans to total loans	59.4	60.1	60.1	60.1	60.8
Non-Performing Loans					
NPLs to total loans	3.7	3.4	2.9	3.1	3.2
NPLs to capital	11.1	12.5	10.9	14.5	13.6
Net charge-offs to loans	0.92	0.39	0.29	4.94	0.14
Provisioning Practices					
Provisions to NPLs	36.1	53.9	62.3	56.6	17.3
Provisions to total loans	1.3	1.8	1.8	1.8	0.6

- The proportion of performing loans to total loans fell during the quarter, but remained relatively high at 96.3%.
- The proportion of provisions to non-performing loans decreased from 53.9% to 36.1%, reflecting an increase in NPLs of 7% as compared to a decrease in provisions of 28.4%.

Sectoral Distribution of Loans

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

Chart III: Sectoral Distribution of Loans and Advances



- The loan book for the sector continued to be dominated by real estate related exposure, reported at 65.7% (Q2

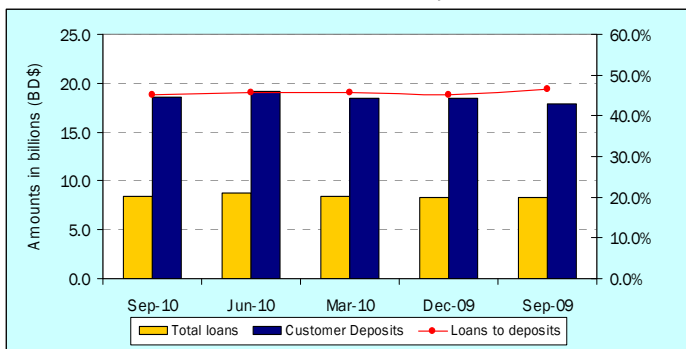
2010: 61.5%) of total loans and advances in the third quarter.

- Other loans and advances decreased during the quarter, from 12.1% in the second quarter to 7.4%.

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.

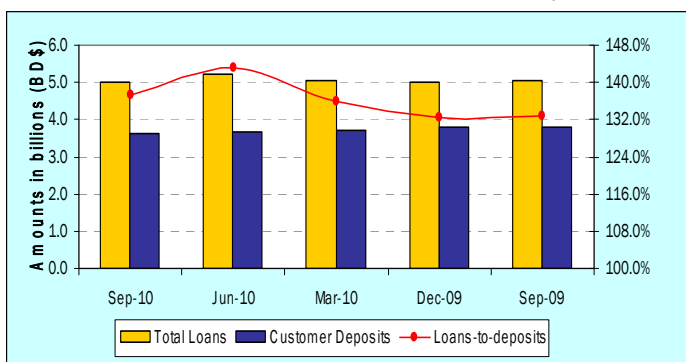
Chart IV: Total Loans and Customer Deposits



- Loans and advances decreased by 3.5% during the quarter while customer deposits decreased by 2.6%. As a result, the loans-to-deposit ratio fell during the quarter from 45.6% to 45.2%.

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

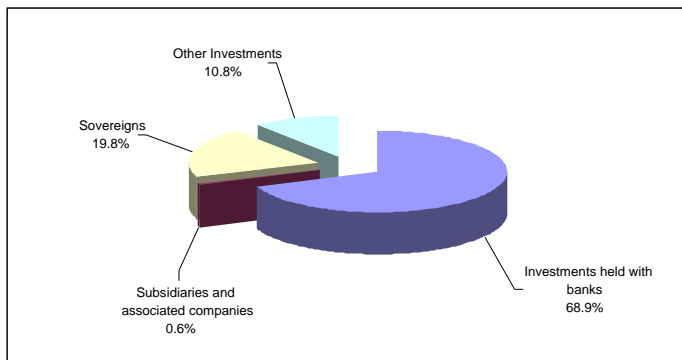


- The Bermuda dollar loans-to-deposits ratio decreased during the quarter from 143.3% in Q2 2010 to 137.4%, but was up slightly from 132.7% a year earlier. The latest quarterly decrease is attributable to a faster decrease of 4.6% in Bermuda dollar-denominated loans and advances, as compared to a 0.4% decrease in Bermuda dollar-denominated customer deposits during the quarter.

Investment Book

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

Chart VI: Structure of the Investment Book



- 'Other investments' decreased from 11.4% in the second quarter to 10.8%.
- Investments held with sovereign entities increased from 9.6% in the second quarter to 19.8%, reflecting a material shift from other asset classes.
- Securities issued by banks comprised 68.9% of the total investment portfolio, down from 73.2% in the second 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	
	Sep	Jun	Mar	Dec	Sep
FX denominated assets to total assets	74.6	74.0	74.1	73.8	73.2
FX denominated loans to total loans	40.6	39.9	39.9	39.9	39.2
FX denominated deposits to total deposits	80.4	80.9	79.8	79.5	78.6
Changes in FX assets	-1.5	3.8	1.8	2.5	-5.0
Changes in FX loans and advances	-2.0	3.8	0.8	2.3	-0.4
Changes in FX customer deposits	-3.1	5.1	0.2	4.7	-3.8

- Foreign currency-denominated customer deposits decreased by 3.1% during the quarter. Within the total, foreign currency savings and time deposits rose by 6.7% and 1.1% respectively, while there was a decrease in foreign currency-denominated demand deposits of 10.3%.

- In Q3 2010, 61.3% (Q2 2010: 63.5%) of total foreign currency assets of BD\$16.6 billion were denominated in US dollars. US dollar assets made up 45.8% (Q2 2010: 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 (%)	
	Sep	Jun	Mar	Dec	Sep	QoQ	YoY
Loans and Advances	5.0	5.2	5.1	5.0	5.1	-4.6	-0.9
Total Assets	5.7	5.9	5.7	5.7	5.7	-4.4	-0.9
Deposit Liabilities	3.6	3.7	3.7	3.8	3.8	-0.4	-4.3
Equity and Subordinated Debt	2.1	2.1	1.6	1.7	1.9	-1.9	9.5

- Total Bermuda dollar assets decreased by 4.4% during the quarter, and by 0.9% year-on-year. The decline in Bermuda dollar assets is mainly attributed to the decrease in Bermuda dollar-denominated loans and advances.

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	
	Sep	Jun	Mar*	Dec	Sep
Interest margin to interest income	83.5	82.6	81.4	80.0	79.1
Interest margin to total income	52.3	45.2	226.2	113.6	50.4
Non-interest expenses to total income	74.5	68.4	365.0	167.7	72.1
Personnel expenses to non-interest expenses	55.5	57.2	60.0	57.4	58.1
Return on assets (ROA)	0.8	1.1	-2.5	-3.1	0.9
Adjusted ROA	0.8	1.1	-2.5	-3.3	0.9
Return on equity (ROE)	6.1	8.8	-21.7	-27.3	7.9
Adjusted ROE	6.1	8.8	-21.7	-27.3	7.9
Interest income to earning assets	2.6	2.5	2.5	2.7	2.8
Interest expenses to customer deposits	0.5	0.5	0.5	0.6	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 third quarter to 83.5% from 82.6% in the second quarter and 79.1% in Q3 2009. The quarterly increase can be

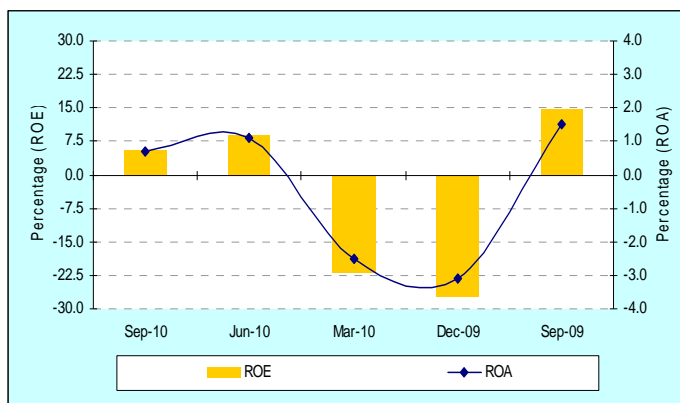
attributed to a decrease in interest expenses of 0.8% as compared to an increase in interest income of 4.9%.

- The quarter-on-quarter increase in interest margin to total income is attributable to an increase in interest margin of 6.1% as compared to a decrease in total income of 8.4%
- The quarter-on-quarter increase in non-interest expenses to total income from 68.4% to 74.5% is a result of a faster decrease in total income of 8.4%, as compared to the marginal decrease in total operating expenses of 0.2%.

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

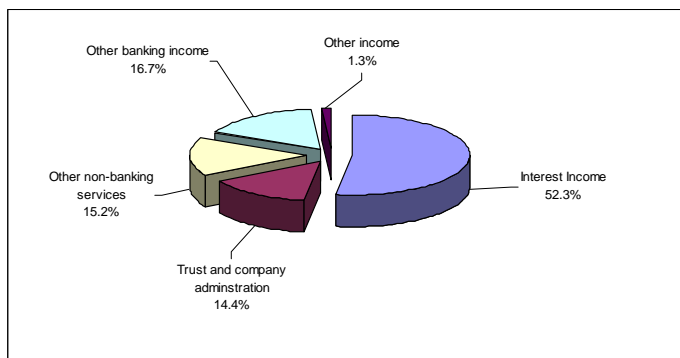


- ROE decreased from 8.8% in the second quarter to 6.1% while ROA decreased from 1.1% to 0.8%. These movements reflect a decrease in profitability mainly attributable to "other income".

Distribution of Income Sources

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

Chart VIII: Distribution of Income Sources

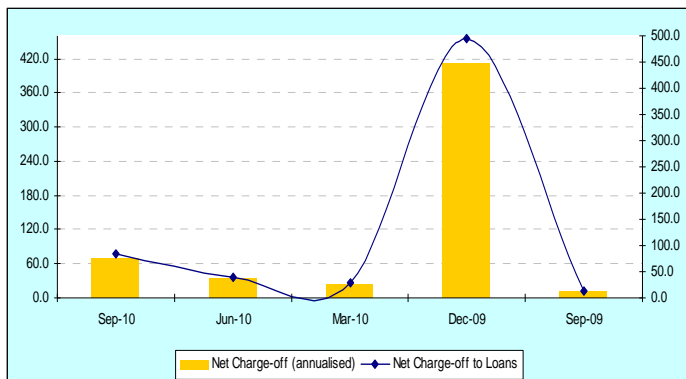


- Interest income contributed 52.3% (Q2 2010: 45.2%) of total income. Income from non-banking services made up 29.6% (Q2 2010: 28.8%) of total income.

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\$8.6 million in the second quarter to BD\$17.5 million.
- The annualised proportion of net charge-off to total loans increased quarter-on-quarter from 0.4% in Q2 2010 to 0.8% in Q3 2010.

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

Table VIII: Bermuda Money Supply (Unconsolidated)

(BD\$ millions)	2010			2009	
	Sep	Jun	Mar	Dec	Sep
Notes and coins in circulation*	122	134	127	137	123
Deposit liabilities	3,706	3,719	3,748	3,840	3,858
Banks and deposit companies	3,828	3,853	3,875	3,977	3,981
Less: Cash at banks and deposit companies	60	73	61	70	60
Bermuda dollar money supply	3,768	3,780	3,814	3,907	3,921
% Growth on previous period	-0.32	-0.89	-2.37	-0.36	0.98
% Growth year-on-year	-3.90	-2.64	-1.44	0.18	0.43

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

- The Bermuda money supply decreased by 0.3% during the quarter and by 3.9% year-on-year.

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.

Group of Governors and Heads of Supervision announces higher global minimum capital standards. At its September 12th 2010 meeting, the Group of Governors and Heads of Supervision, the oversight body of the Basel Committee on Banking Supervision (BCBS), announced a substantial strengthening of existing capital requirements and fully endorsed the agreements it reached on 26th July 2010. The Committee's package of reforms will increase the minimum common equity requirement from 2% to 4.5%. In addition, banks will be required to hold a capital conservation buffer of 2.5% to withstand future periods of stress bringing the total common equity requirements to 7%. This reinforces the stronger definition of capital agreed by Governors and Heads of Supervision in July and the higher capital requirements for trading, derivative and securitisation activities to be introduced at the end of 2011.

The Financial Stability Board (FSB) and Basel Committee on Banking Supervision (BCBS) published in August its report, "Assessment of the macroeconomic impacts of stronger capital and liquidity requirements" and "An assessment of the long term impact of stronger capital and liquidity requirements". The reports were 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 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 Financial Stability Board, in consultation with the International Monetary Fund, released its report, "Intensity and Effectiveness of SIFI Supervision". This report sets out recommendations for making the supervision of financial institutions more intense, effective and reliable. The recommendations are drawn from an internationally co-ordinated assessment of lessons from the financial crisis. While the recommendations are primarily aimed at making SIFIs less susceptible to failure, there are also lessons for the supervision of financial institutions more generally.

The Basel Committee on Banking Supervisors established a working group to conduct a "top-down" approach in calibrating regulatory minimum capital requirements and capital buffers that should be held in banks. The report looks at the calibration of common equity and Tier 1 risk-based ratios and the Tier 1 leverage ratio, as well as the regulatory buffers above the common equity and Tier 1 risk-based ratios and findings from the working group.

The Financial Stability Board issued its report, “Reducing the moral hazard posed by systemically important financial institutions” in October 2010. The report recommends a policy framework to address systemically important financial institutions that could potentially pose systemic and moral hazard risks as a result of their size and complexity, disrupting the financial system and economic activity.

The Joint Forum released its report, “Developments in Modelling Risk Aggregation” in October 2010. It suggests improvements to the current modelling techniques used by complex firms to aggregate risks. It also examines supervisory approaches to firms' use of risk aggregation models, particularly in light of the global financial crisis.

The Basel Committee on Banking Supervision (BCBS) issued for consultation a report on the “Range in methodologies for Risk and Performance Alignment of Remuneration” in October 2010. The report presents a range of practices and methodologies as possible approaches to aligning remuneration and risk. The report focuses on particular issues that may reduce the effectiveness of the risk adjustment process as well as challenges that should be considered by banks when developing their methodologies, and by supervisors, when reviewing and assessing banks' practices.

The Basel Committee of Banking Supervision (BCBS) issued the final version of its paper “Good Practice Principles on Supervisory Colleges” in October 2010. The principles aim to strengthen international co-operation and supervision of internationally active banks by promoting the adoption of established good practices for operating supervisory colleges.

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 are 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.
