

Quarterly Banking Digest

Q4 2010

HIGHLIGHTS

- The aggregate risk asset ratio for the Bermuda banking sector increased for the fourth consecutive quarter. Since Q1 2010, the aggregate risk asset ratio has improved from 20.2% to stand at 25.6% at end-December 2010.
- The sector's profitability decreased during the quarter, the return on equity (ROE) falling from 6.1% in Q3 2010 to 4.5%, while the return on assets (ROA) fell from 0.8% in Q3 2010 to 0.6%.
- There was a sharp increase in non-performing loans, up from 3.7% to 5.7% of total loans. For the most part, the new loans classified as non-performing were not so impaired as to require additional provisions.
- Performing loans remained relatively high at 94.3% of total loans.
- Provisions fell sharply, reflecting a corresponding write-off of certain loans previously classified as non-performing. Taken together with the rise in non-performing loans, this resulted in the ratio of provisions to non-performing loans falling from 36.1% to 18.8%.
- Both total assets and customer deposits increased during the quarter by 4.9% and 5.4% respectively. The increase in customer deposits was mainly driven by a 7.0% rise in foreign currency-denominated customer deposits.

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
	Dec	Sep	Jun	Mar	Dec
Capital Position					
Risk Asset Ratio	25.6	25.0	21.0	20.2	15.5
Asset to Regulatory Capital Multiple	8.2	7.8	9.7	9.9	12.1
Equity to Total Assets	12.4	13.1	12.5	12.2	10.7
Profitability					
Interest margin to interest income	83.6	83.5	82.6	81.4	80.0
Return on assets	0.6	0.8	1.1	-2.5	-3.1
Return on equity	4.5	6.1	8.8	-21.7	-27.3

Table I: Selected Indicators (Part II)

(Ratios in percentages)	2010				2009
	Dec	Sep	Jun	Mar	Dec
Loan Book					
Provisions to Non-Performing Loans (NPLs)	18.8	36.1	53.9	62.3	56.6
NPLs to total loans	5.7	3.7	3.4	2.9	3.1
NPLs to capital	17.2	11.1	12.5	10.9	14.5
Other					
BD\$ money supply growth	-1.22	-0.4	-0.9	-2.4	-0.4
Asset growth rate	4.9	-2.2	3.9	1.4	1.6
Customer deposits growth rate	5.4	-2.6	3.7	-0.1	3.6
FX denominated deposits to total deposits	81.7	80.4	80.9	79.8	79.5
Loans to deposits	44.0	45.2	45.7	45.7	45.2

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 (%)	
	Dec	Sep	Jun	Mar	Dec	QoQ	YoY
Assets							
Cash	0.1	0.1	0.1	0.1	0.1	10.2	-1.1
Deposits	7.2	6.4	6.6	6.3	5.7	12.0	27.4
Loans & Advances	8.6	8.4	8.7	8.4	8.3	2.5	3.5
Investments	6.4	6.3	6.2	6.1	6.5	2.1	-1.1
Other Assets	1.1	1.1	1.1	1.0	1.1	-2.0	-2.4
Total Assets	23.4	22.3	22.8	21.9	21.6	4.9	8.1
Liabilities							
Savings Deposits	4.8	4.8	4.6	4.7	4.5	0.5	7.9
Demand Deposits	8.1	7.3	8.0	7.8	8.1	11.7	0.2
Time Deposits	6.7	6.6	6.5	5.9	5.9	2.0	13.6
Total Deposits	19.6	18.6	19.1	18.4	18.5	5.4	6.3
Other Liabilities	0.5	0.4	0.5	0.5	0.6	26.7	-4.0
Total Liabilities	20.2	19.1	19.7	19.0	19.1	5.8	6.0
Equity and Subordinated Debt	3.2	3.2	3.1	3.0	2.6	-0.6	23.0
Total Liabilities and Equity	23.4	22.3	22.8	21.9	21.6	4.9	8.1

Totals may not add due to rounding

- Total assets increased by 4.9% during the quarter and 8.1% year-on-year.
- Within this aggregate, deposits with other financial institutions increased by 12.0% during the quarter and 27.4% year-on-year.
- Total customer deposits increased during the quarter by 5.4% and 6.3% year-on-year. The most significant increase during the quarter pertained to demand deposits, up by 11.7%. This change was driven primarily by a 20.9% increase in US dollar-denominated demand deposits.
- Time deposits increased by 2.0% for the quarter and 13.6% year-on-year. The main driver was from US dollar-denominated time deposits, which increased by 26.2% for the year.

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
	Dec	Sep	Jun	Mar	Dec
Asset Allocation					
Investments	27.3	28.1	27.4	28.0	29.9
Loans	36.9	37.8	38.3	38.4	38.6
Deposits	30.8	28.9	29.1	28.7	26.1
Deposits Allocation					
Savings	24.5	25.7	23.9	25.8	24.2
Demand	41.4	39.1	42.0	42.1	43.9
Time	34.1	35.2	34.0	32.1	31.9
Capital Position					
Risk Asset Ratio	25.6	25.0	21.0	20.2	15.5
Equity to Total Assets	12.4	13.1	12.5	12.2	10.7
Asset to Regulatory Capital Multiple	8.2	7.8	9.7	9.9	12.1
Loan Book					
NPLs to total loans	5.7	3.7	3.4	2.9	3.1
Provisions to NPLs	18.8	36.1	53.9	62.3	56.6
Provisions to total loans	1.1	1.3	1.8	1.8	1.8

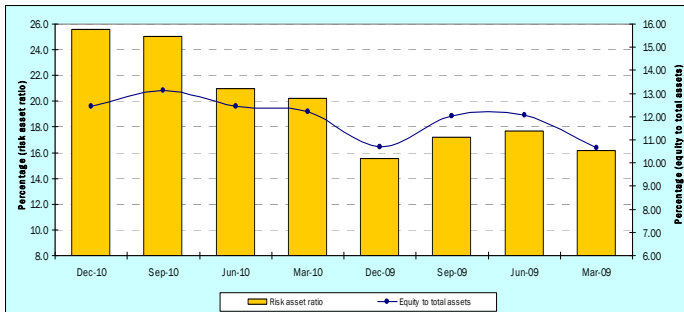
Totals may not add due to rounding

- The proportion of assets allocated to investments decreased from 28.1% in the third quarter to 27.3%.
- Overall deposits increased from 28.9% in Q3 2010 to 30.8%
- The sector's risk asset ratio increased from 25.0% to 25.6%, driven mainly by a 2.1% increase in reported regulatory capital.
- The leverage ratio decreased from 13.1% in Q3 2010 to 12.4% but remains above the 10.7% level of a year earlier.

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

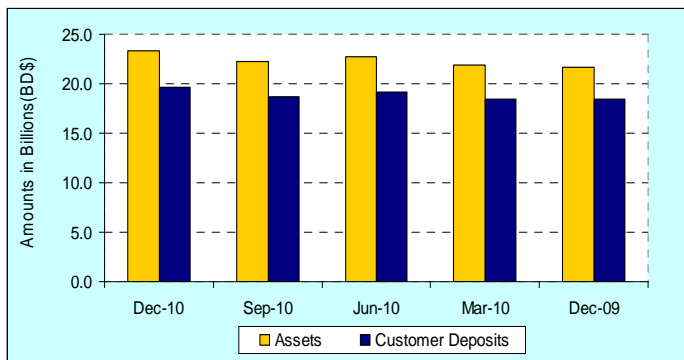


- The aggregate risk asset ratio rose to 25.6%, showing continued improvement in capital levels for the sector for the fourth consecutive quarter.
- Equity to total assets (leverage ratio) decreased quarter-on-quarter from 13.1% to 12.4%.

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\$22.3 billion to BD\$23.4 billion. The increase was driven mainly by a rise in deposits with other financial institutions of 12.0%.
- Total customer deposit liabilities increased from BD\$18.6 billion to BD\$19.6 billion. The increase was attributable to a rise in demand deposits of 11.4%, time deposits of 2.0% and a marginal increase in savings deposits of 0.5%.

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

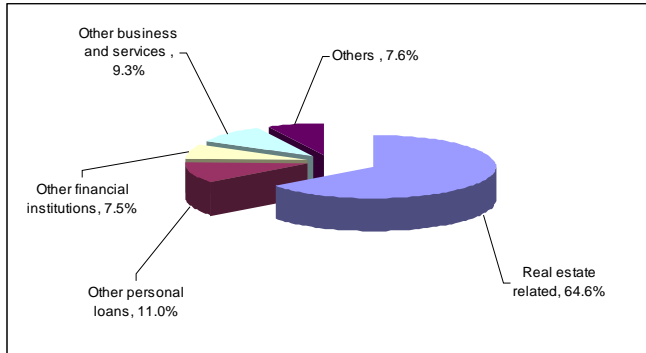
(Ratios in percentages)	2010				2009
	Dec	Sep	Jun	Mar	Dec
Loans and advances quarter-over-quarter growth rate	2.5	-3.5	3.7	1.0	0.4
Mortgages on residential property to total loans	51.9	53.3	51.1	52.5	52.3
BD\$ denominated loans to total loans	58.2	59.4	60.1	60.1	60.1
Non-Performing Loans					
NPLs to total loans	5.7	3.7	3.4	2.9	3.1
NPLs to capital	17.2	11.1	12.5	10.9	14.5
Net charge-offs to loans	1.1	0.8	0.4	0.3	4.9
Provisioning Practices					
Provisions to NPLs	18.8	36.1	53.9	62.3	56.6
Provisions to total loans	1.1	1.3	1.8	1.8	1.8

- The proportion of performing loans to total loans fell slightly during the quarter, but remained relatively high at 94.3%.
- The proportion of non-performing loans ('NPLs') to total loans rose during the quarter from 3.7% to 5.7%; the increase occurred mainly in those categories of loans deemed not to require material provisions. At the same time, there was a sharp fall in provisions, corresponding to a substantial write-off of problem loans no longer considered collectable. As a result, the ratio of provisions to NPLs fell from 36.1% to 18.8%.

Sectoral Distribution of Loans

Chart III below shows the sectoral distribution of loans as at 31st December 2010.

Chart III: Sectoral Distribution of Loans and Advances

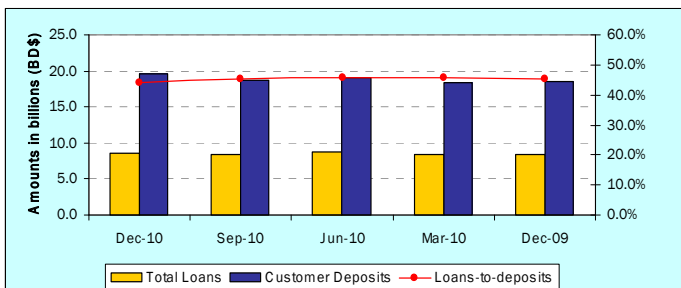


- The loan book for the sector continued to be dominated by real estate-related exposure, reported at 64.6% (Q3 2010: 65.7%) of total loans and advances in Q4.
- Other business and services increased during the quarter, from 6.9% in Q3 2010 to 9.3%.

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.

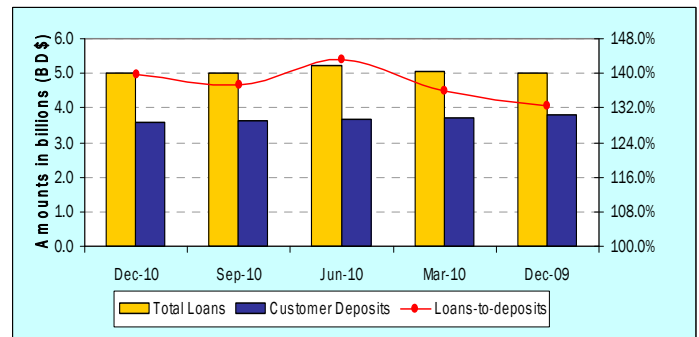
Chart IV: Total Loans and Customer Deposits



- Loans and advances decreased by 2.5% during the quarter while customer deposits increased by 5.4%. As a result, the loans-to-deposit ratio fell during the quarter from 45.2% to 44.0%.

Chart V 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

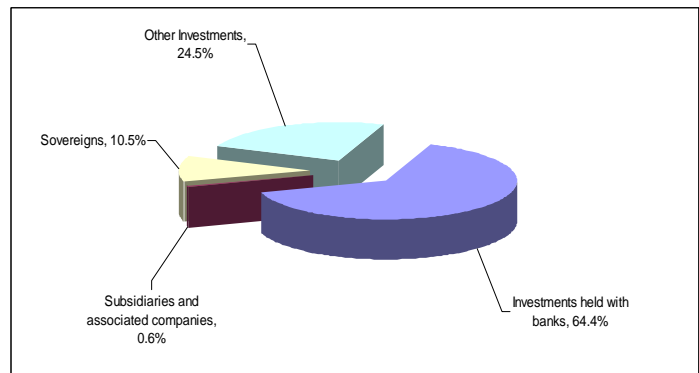


- The Bermuda dollar loans-to-deposits ratio increased during the quarter from 137.4% in Q3 2010 to 139.7%, up from 132.4% a year earlier. The latest quarterly increase is attributable to an increase of 0.4% in Bermuda dollar-denominated loans and advances, as compared to a 1.2% decrease in Bermuda dollar-denominated customer deposits during the quarter.

Investment Book

Chart VI below shows the structure of the aggregate investment book as at 31st December 2010.

Chart VI: Structure of the Investment Book



- 'Other investments' increased from 10.8% in Q3 2010 to 24.5%.
- Within the 'other investments' category, the main change has been an increase in exposures to non-equity tranches of securitisation instruments which accounted for 72.2% of 'other investments' and 17.7% of the total investment portfolio in Q4 2010.
- The shift to non-equity tranches of securitisation instruments reflects investments in securities issued by US government-sponsored agencies.
- Investments held with sovereign entities decreased from 19.8% in Q3 2010 to 10.5%, the counterpart primarily of the shift to 'other investments'.

- Securities issued by banks comprised 64.4% of the total investment portfolio, down from 68.9% in Q3 2010.

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
	Dec	Sep	Jun	Mar	Dec
FX denominated assets to total assets	75.7	74.6	74.0	74.1	73.8
FX denominated loans to total loans	41.8	40.6	39.9	39.9	39.9
FX denominated deposits to total deposits	81.7	80.4	80.9	79.8	79.5
Changes in FX assets	6.5	-1.5	3.8	1.8	2.5
Changes in FX loans and advances	5.4	-2.0	3.8	0.8	2.3
Changes in FX customer deposits	7.0	-3.1	5.1	0.2	4.7

- Foreign currency-denominated customer deposits increased by 7.0% during the quarter. Within the total, foreign currency demand and time deposits rose by 13.5% and 3.1% respectively. The latest quarterly increase is attributed to a rise in US dollar-denominated demand deposits, which increased by 20.9% during the quarter.
- In Q4 2010, 64.0% (Q3 2010: 61.3%) of total foreign currency assets of BD\$17.7 billion were denominated in US dollars. US dollar assets made up 48.5% (Q3 2010: 45.6%) of total assets for the sector.
- Foreign currency-denominated assets as compared to total assets have grown steadily over the last four quarters. This was mainly the result of continued growth in foreign currency-denominated deposits, up by 7% during the quarter and 11.9% over a year earlier.

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 (%)	
	Dec	Sep	Jun	Mar	Dec	QoQ	YoY
Loans and Advances	5.0	5.0	5.2	5.1	5.0	0.4	0.4
Total Assets	5.7	5.7	5.9	5.7	5.7	0.3	0.2
Deposit Liabilities	3.6	3.6	3.7	3.7	3.8	-1.2	-4.9
Equity and Subordinated Debt	2.1	2.1	2.1	1.6	1.7	2.1	23.7

- Total Bermuda dollar assets were little changed over the most recent quarter and over the past year.

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
	Dec	Sep	Jun	Mar*	Dec
Interest margin to interest income	83.6	83.5	82.6	81.4	80.0
Interest margin to total income	54.6	52.3	45.2	226.2	113.6
Non-interest expenses to total income	75.6	74.5	68.4	365.0	167.7
Personnel expenses to non-interest expenses	54.3	55.5	57.2	60.0	57.4
Return on assets (ROA)	0.6	0.8	1.1	-2.5	-3.1
Adjusted ROA	0.6	0.8	1.1	-2.5	-3.3
Return on equity (ROE)	4.5	6.1	8.8	-21.7	-27.3
Adjusted ROE	4.5	6.1	8.8	-21.7	-27.3
Interest income to earning assets	2.6	2.6	2.5	2.5	2.7
Interest expenses to customer deposits	0.5	0.5	0.5	0.5	0.6

* 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.

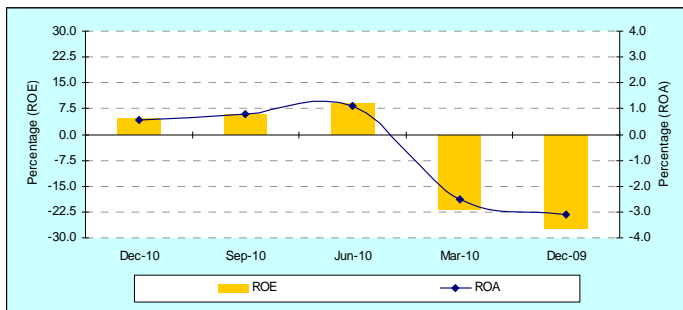
Margin Analysis

- The interest margin to interest income increased slightly in the fourth quarter to 83.6% from 83.5% in Q3 2010 and 80.0% in Q4 2009.
- The interest margin to total income increased in the fourth quarter to 54.6% from 52.3% in the third quarter. This is attributed to an increase in interest margin of 2.1% as compared to a decrease in total income of 2.2%.
- The quarter-on-quarter increase in non-interest expenses to total income from 74.5% to 75.6% is a result of a faster decrease in total income of 2.2% compared to a 0.8% decrease in total operating expenses.

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

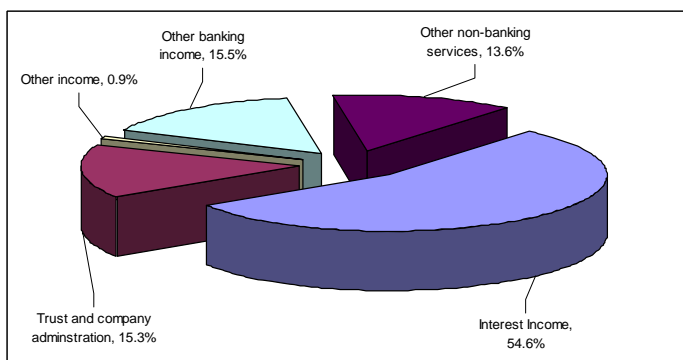


- ROE decreased from 6.1% in the third quarter to 4.5% while ROA decreased from 0.8% to 0.4%. These movements reflect a decrease in profitability mainly attributable to 'other banking income' and 'bad debt provisioning'.

Distribution of Income Sources

Chart VIII below shows the distribution of income sources for the year ended 31st December 2010.

Chart VIII: Distribution of Income Sources

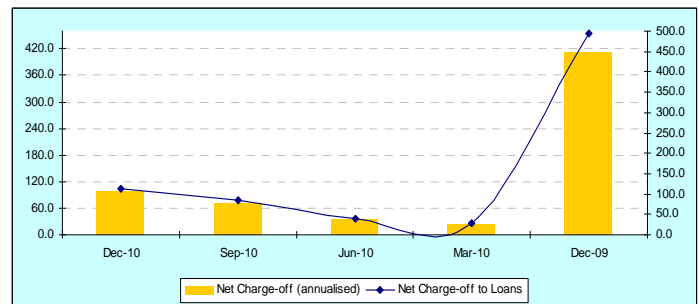


- Interest income contributed 54.6% (Q3 2010: 52.3%) of total income while the share of other banking income fell from 16.7% in Q3 to 15.5%. Income from non-banking services made up 29.8% (Q3 2010: 29.6%) of total income.

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) in Q4 2010 totalled BD\$24.4 million, compared to BD\$17.5 million in Q3 2010 and \$103m in Q4 2009.
- The annualised proportion of net charge-off to total loans increased quarter-on-quarter from 0.8% in Q3 2010 to 1.1% in Q4 2009.

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
	Dec	Sep	Jun	Mar	Dec
Notes and coins in circulation*	127	127	134	127	137
Deposit liabilities	3,660	3,706	3,719	3,748	3,840
Banks and deposit companies	3,787	3,828	3,853	3,875	3,977
Less: Cash at banks and deposit companies	65	60	73	61	70
Bermuda dollar money supply	3,722	3,768	3,780	3,814	3,907
% Growth on previous period	-1.22	-0.32	-0.89	-2.4	-0.4
% Growth year-on-year	-4.73	-3.90	-2.64	-1.4	0.2

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

- The Bermuda money supply decreased by 1.2% during the quarter and by 4.7% 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.

Bank for International Settlements (BIS) Publications

In February, the BIS issued its working paper no. 338 entitled, "BASEL III: Long term impact on economic performance and fluctuations". This study presents an assessment of the long-term economic costs of the new rules introducing tighter capital and liquidity requirements proposed by the Basel Committee on Banking Supervision ('Basel Committee') commonly referred to as the Basel III reform package. Specifically, the paper addresses the following key questions - what is the impact of higher capital requirements and tighter liquidity regulation on economic fluctuations?

In February, the BIS issued its working paper no. 337 entitled, "Macroprudential policy – a literature review". The paper covers the need to go beyond a purely micro approach to financial regulation and supervision by providing a research overview on this topic. The paper looks at parallels with the research literature on monetary policy, in particular, policy objectives, intermediate targets, instruments and the transmission mechanisms.

The BIS released its working paper no. 336 entitled, "Policymaking from a "macroprudential" perspective in emerging market economies". The paper reviews instruments used to mitigate the effects of capital flows, which have financial stability implications. Some instruments, such as foreign exchange market intervention and foreign reserve accumulation, measures to strengthen bank balance sheets and capital; and measures to maintain the quality of credit or to influence credit growth are discussed along with implementation issues and the intermediate concerns.

The BIS released its Quarterly Review, "International banking and financial market developments", in December 2010. The report looks at various key areas, such as monetary policy and sovereign debt concerns impacting markets, and highlights international banking and financial market activity.

The BIS released its working paper no. 324, "Mapping capital and liquidity requirements to bank lending spreads". This study outlines a methodology for mapping the increases in capital and liquidity requirements proposed under Basel III to bank lending spreads.

The Basel Committee Developments

The Basel Committee issued its final elements of the reforms to raise the quality of regulatory capital. The report outlines the minimum requirements to ensure that all classes of capital instruments fully absorb losses at the point of non-viability before taxpayers are exposed to loss. The requirements cover the scope of post-trigger instruments, defining the trigger event, group treatment and transition period for instruments meeting the criteria to be included in regulatory capital.

The Basel Committee issued, in January, its minimum requirements to ensure loss absorbency at the point of non-viability. The requirements set out the criteria for all non-common Tier 1 and Tier 2 instruments issued by internationally active banks. It outlines the scope and post trigger instruments, the definition of at trigger event, group treatment and transitional arrangements for instruments issued prior to, on or after January 1, 2013.

The Basel Committee issued in December 2010, its Basel III rules text, "BASEL III: International framework for liquidity risk measurement, standards and monitoring". The text presents the details of the global regulatory standards on bank capital adequacy and liquidity agreed by the Governors and Heads of Supervision, which oversees the Basel Committee. The objective of the reforms is to improve the banking sector's ability to absorb shocks arising from financial and economic stress, thus reducing the risk of spillover from the financial sector to the real economy.

Other Developments

The Macroeconomic Assessment Group (MAG), established in February 2010, issued a final report, "Assessing the macroeconomic impact of the transition to stronger capital and liquidity requirements (Final report)". The Final Report builds on the Interim Report's findings by simulating the macroeconomic impact of the changes to capital standards that were agreed in September 2010 by the group of Governors and Heads of Supervision (GHOS). Among other reforms, the GHOS proposed a strengthened definition of capital; calibrated requirements for minimum capital ratios and for a new capital conservation buffer; and specified a transition path for the new standards.

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 (TRWA) 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.
