

Quarterly Banking Digest

Q1 2011

HIGHLIGHTS

- The aggregate risk asset ratio of Bermuda banks decreased during Q1 2011 but remained above 21%, which in turn is high by international standards. Leverage, measured by the equity to total assets ratio, remained unchanged at 12.4%.
- Profitability increased during the quarter. The return on equity (ROE) rose from 4.5% in Q4 2010 to 8.8% while the return on assets (ROA) increased from 0.6% to 1.1 %, driven by an increase in banking income of 6.2% and a decrease in operating expenses of 3.4%.
- Performing loans remained at 94.5% of total loans.
- Net charge offs declined during the quarter from 1.1% to 0.3% of total lending, down from the higher levels of the previous two quarters.
- Holdings of securities issued by banks fell to 55.1% of total investments, down from 64.4% in the previous quarter. There was a corresponding increase in 'other investments', which increased from 24.5% in Q4 2010 to 32.0%.

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)	2011		2010		
	Mar	Dec	Sep	Jun	Mar
Capital Position					
Risk Asset Ratio	21.3	25.6	25.0	21.0	20.2
Asset to Regulatory Capital Multiple	9.9	8.2	7.8	9.7	9.9
Equity to Total Assets	12.4	12.4	13.1	12.5	12.2
Profitability					
Interest margin to interest income	84.8	83.6	83.5	82.6	81.4
Return on assets	1.1	0.6	0.8	1.1	-2.5
Return on equity	8.8	4.5	6.1	8.8	-21.7

Table I: Selected Indicators (Part II)

(Ratios in percentages)	2011	2010			
	Mar	Dec	Sep	Jun	Mar
Loan Book					
Provisions to Non-Performing Loans (NPLs)	20.2	18.8	36.1	53.9	62.3
NPLs to total loans	5.5	5.7	3.7	3.4	2.9
NPLs to capital	20.4	17.2	11.1	12.5	10.9
Other					
BD\$ money supply growth	-5.87	-1.22	-0.4	-0.9	-2.4
Asset growth rate	-1.2	4.9	-2.2	3.9	1.4
Customer deposits growth rate	-0.5	5.4	-2.6	3.7	-0.1
FX denominated deposits to total deposits	81.7	81.7	80.4	80.9	79.8
Loans to deposits	44.5	44.0	45.2	45.7	45.7

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)	2011	2010				Change (%)	
	Mar	Dec	Sep	Jun	Mar	QoQ	YoY
Assets							
Cash	0.1	0.1	0.1	0.1	0.1	-3.7%	5.2%
Deposits	6.7	7.2	6.4	6.6	6.3	-7.5%	5.9%
Loans & Advances	8.7	8.6	8.4	8.7	8.4	0.7%	3.2%
Investments	6.6	6.4	6.3	6.2	6.1	3.2%	7.5%
Other Assets	1.1	1.1	1.1	1.1	1.0	-0.2%	4.8%
Total Assets	23.1	23.4	22.3	22.8	21.9	-1.2%	5.3%
Liabilities							
Savings Deposits	4.9	4.8	4.8	4.6	4.7	1.8%	2.9%
Demand Deposits	8.1	8.1	7.3	8.0	7.8	-1.0%	3.7%
Time Deposits	6.6	6.7	6.6	6.5	5.9	1.4%	11.3%
Total Deposits	19.5	19.6	18.6	19.1	18.4	-0.5%	5.9%
Other Liabilities	0.4	0.5	0.4	0.5	0.5	-23.2%	-21%
Total Liabilities	20.0	20.2	19.1	19.7	19.0	-1.1%	5.2%
Equity and Subordinated Debt	3.1	3.2	3.2	3.1	3.0	-1.6%	5.8%
Total Liabilities and Equity	23.1	23.4	22.3	22.8	21.9	-1.2	6.3%

Totals may not add due to rounding

- Total assets decreased by 1.2% during the quarter but increased 5.3% year-on-year.
- Within this aggregate, deposits with other financial institutions fell by 7.5% during the quarter but increased by 5.9% year-on-year. Loans and advances were relatively flat in Q1 (but rose 3.2% year-on-year) while investments were up by 3.2% in the latest quarter (and up by 7.5% a year earlier).
- Total customer deposits decreased during the quarter by 0.5% but increased by 5.9% year-on-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)	2011	2010			
	Mar	Dec	Sep	Jun	Mar
Asset Allocation					
Investments	28.6	27.3	28.1	27.4	28.0
Loans	37.6	36.9	37.8	38.3	38.4
Deposits	28.8	30.8	28.9	29.1	28.7
Deposits Allocation					
Savings	25.0	24.5	25.7	23.9	25.8
Demand	41.2	41.4	39.1	42.0	42.1
Time	33.8	34.1	35.2	34.0	32.1
Capital Position					
Risk Asset Ratio	21.3	25.6	25.0	21.0	20.2
Equity to Total Assets	12.4	12.4	13.1	12.5	12.2
Asset to Regulatory Capital Multiple	9.9	8.2	7.8	9.7	9.9
Loan Book					
NPLs to total loans	5.5	5.7	3.7	3.4	2.9
Provisions to NPLs	20.2	18.8	36.1	53.9	62.3
Provisions to total loans	1.1	1.1	1.3	1.8	1.8

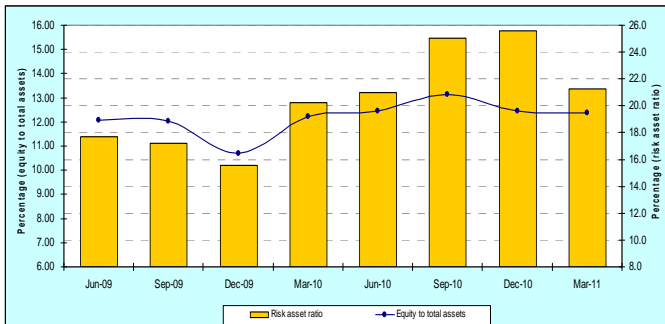
Totals may not add due to rounding

- The proportion of assets allocated to investments increased from 27.3% in the fourth quarter to 28.6% in Q1 2011.
- Deposits with other banks decreased from 30.8% in Q4 2010 to 28.8% in Q1 2011.
- The sector's risk asset ratio decreased from 25.6% to 21.3%.
- The asset to regulatory capital multiple (a measure of gearing) increased from 8.2 to 9.9.
- Provisions rose by 11.4% in Q1 2011 while NPLs fell by 2.4%. As a result, there was an improvement in the ratio of provisions to NPLs from 18.8% in Q4 2010 to 20.2% in Q1 2011.

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

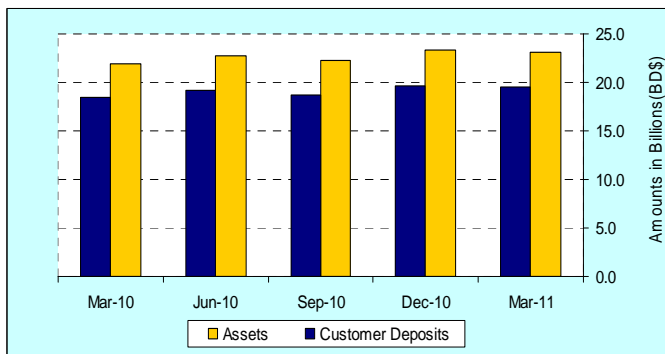


- The aggregate risk asset ratio fell to 21.3% in Q1 2011 from 25.6% the previous quarter, primarily reflecting a balance sheet adjustment by one institution.
- The equity to total assets ratio remained at 12.4% for the quarter.

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 decreased during the quarter from BD\$23.4 billion to BD\$23.1 billion. The decrease was driven mainly by a decline in deposits with other financial institutions of 7.5%.
- Total customer deposit liabilities fell slightly from BD\$19.6 billion to BD\$19.5 billion.

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

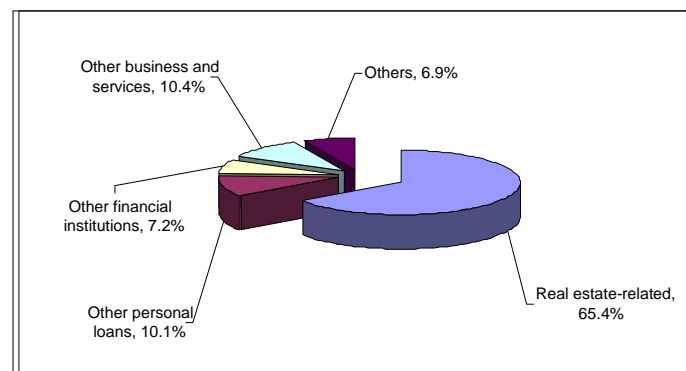
(Ratios in percentages)	2011	2010			
	Mar	Dec	Sep	Jun	Mar
Loans and advances quarter-over-quarter growth rate	0.7	2.5	-3.5	3.7	1.0
Mortgages on residential property to total loans	51.7	51.9	53.3	51.1	52.5
BD\$ denominated loans to total loans	58.5	58.2	59.4	60.1	60.1
Non-Performing Loans					
NPLs to total loans	5.5	5.7	3.7	3.4	2.9
NPLs to capital	20.4	17.2	11.1	12.5	10.9
Net charge-offs to loans	0.3	1.1	0.8	0.4	0.3
Provisioning Practices					
Provisions to NPLs	20.2	18.8	36.1	53.9	62.3
Provisions to total loans	1.1	1.1	1.3	1.8	1.8

- The proportion of performing to total loans rose during the quarter from 94.3% to 94.5%.
- Net charge offs amounted to 0.3% of total loans, down from the higher levels of the previous two quarters.

Sectoral Distribution of Loans

Chart III below shows the sectoral distribution of loans as at 31st March 2011.

Chart III: Sectoral Distribution of Loans and Advances

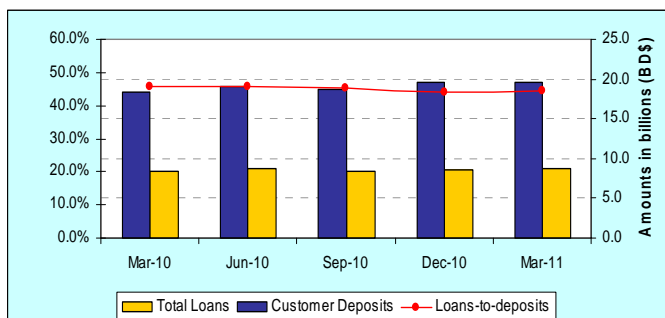


- The loan book continued to be dominated by real estate-related exposure, reported at 65.4% (Q4 2010: 64.6%) of total loans and advances in Q1 2011.
- Other personal loans decreased from 11.0% to 10.1% during the quarter, and there was a corresponding shift in loans to 'other business and services', up from 9.3% in Q4 2010 to 10.4%.

Loan-to-Deposit 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.

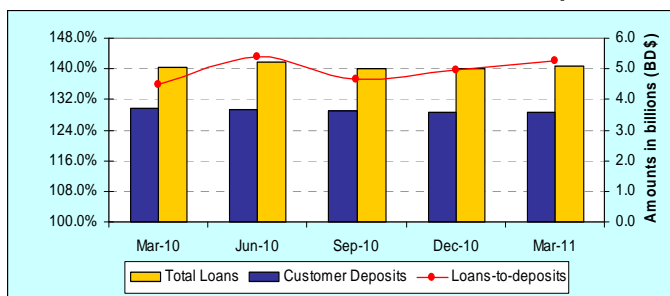
Chart IV: Total Loans and Customer Deposits



- Loans and advances increased by 0.7% during the quarter while customer deposits decreased by 0.5%. As a result, the loan-to-deposit ratio rose slightly during the quarter from 44.0% to 44.5%.

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

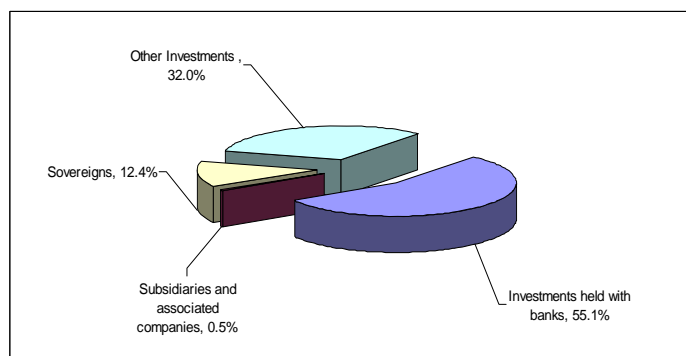


- The Bermuda dollar loans-to-deposits ratio increased from 139.7% in Q4 2010 to 142.0%, up from 136.0% a year earlier. The latest increase is attributable to an increase of 1.1% in Bermuda dollar-denominated loans and advances, as compared to a 0.5% decrease in Bermuda dollar-denominated customer deposits during the quarter.

Investment Book

Chart VI below shows the structure of the aggregate investment book as at 31st March 2011.

Chart VI: Structure of the Investment Book



- There was a marked shift in the composition of the investment portfolio in Q1 2011. Securities issued by banks fell to 55.1% of total investments, down from 64.4% in Q4 2010, while 'other investments' increased from 24.5% to 32.0%.
- Within the 'other investments' category, the main change was an increase in investments in the capital of other banks and financial companies which increased from 0.1% in Q4 2010 to 7.0%.

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)	2011	2010			
	Mar	Dec	Sep	Jun	Mar
FX denominated assets to total assets	75.0	75.7	74.6	74.0	74.1
FX denominated loans to total loans	41.5	41.8	40.6	39.9	39.9
FX denominated deposits to total deposits	81.7	81.7	80.4	80.9	79.8
Changes in FX assets	-2.1	6.5	-1.5	3.8	1.8
Changes in FX loans and advances	0.1	5.4	-2.0	3.8	0.8
Changes in FX customer deposits	-0.5	7.0	-3.1	5.1	0.2

- Foreign currency-denominated customer deposits decreased by 0.5% during the quarter.
- In Q1 2011, 62.5% (Q4 2010: 64.0%) of total foreign currency assets of BD\$17.3 billion were denominated in US dollars. US dollar assets made up 46.9% (Q4 2010: 48.5%) 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)	2011	2010				Change (%)	
	Mar	Dec	Sep	Jun	Mar	QoQ	YoY
Loans and Advances	5.1	5.0	5.0	5.2	5.1	1.2	0.4
Total Assets	5.8	5.7	5.7	5.9	5.7	1.6	1.5
Deposit Liabilities	3.6	3.6	3.6	3.7	3.7	-0.5	-3.8
Equity and Subordinated Debt	2.0	2.1	2.1	2.1	1.6	-4.4	22.9

- There was little change to total Bermuda dollar assets and deposit liabilities over the quarter.

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)	2011	2010			
	Mar	Dec	Sep	Jun	Mar*
Interest margin to interest income	84.8	83.6	83.5	82.6	81.4
Interest margin to total income	54.4	54.6	52.3	45.2	226.2
Non-interest expenses to total income	69.1	75.6	74.5	68.4	365.0
Personnel expenses to non-interest expenses	56.8	54.3	55.5	57.2	60.0
Return on assets (ROA)	1.1	0.6	0.8	1.1	-2.5
Adjusted ROA	1.1	0.6	0.8	1.1	-2.5
Return on equity (ROE)	8.8	4.5	6.1	8.8	-21.7
Adjusted ROE	8.8	4.5	6.1	8.8	-21.7
Interest income to earning assets	2.7	2.6	2.6	2.5	2.5
Interest expenses to customer deposits	0.5	0.5	0.5	0.5	0.5

* 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.

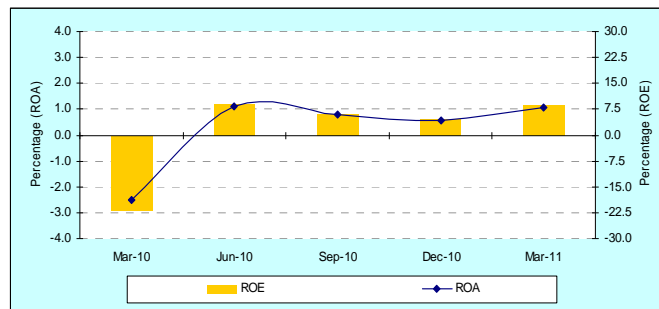
Margin Analysis

- The interest margin to interest income was 84.8% in Q1 2011, up from 83.6% in Q4 2010 and 80.0% in Q1 2010.
- The quarter-on-quarter decrease in non-interest expenses to total income from 75.6% to 69.1% was a result of an increase in total income of 5.6% and a 3.4% 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: Annualised Return on Assets and Return on Equity

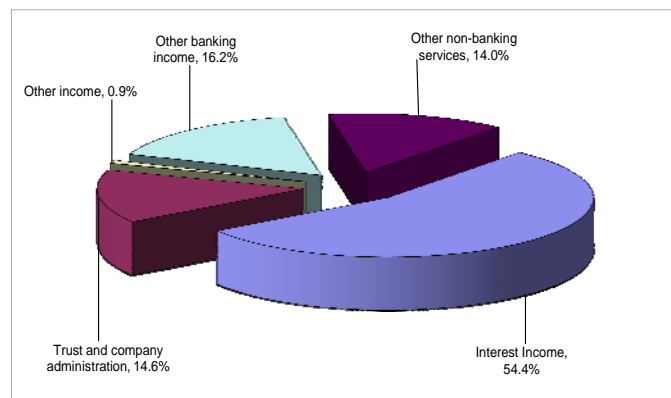


- ROE increased from 4.5% in Q4 2010 to 8.8% in Q1 2011, while ROA increased from 0.6% to 1.1%. The increase in profitability these indices illustrate was mainly attributable to an increase in 'banking income' of 6.2% and a decrease in 'operating expenses' of 3.4% during the quarter.

Distribution of Income Sources

Chart VIII below shows the distribution of income sources for the year ended 31st March 2011.

Chart VIII: Distribution of Income Sources

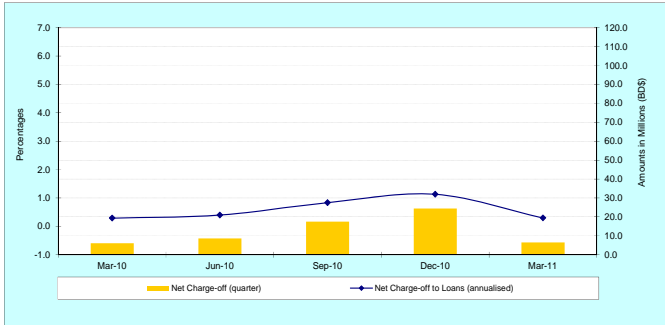


- Interest income contributed 54.4% (Q4 2010: 54.6%) of total income while the share of other banking income rose from 15.5% in Q4 2010 to 16.2%. Income from non-banking services made up 29.5% (Q4 2010: 29.8%) of total income.

Net Profit and Loss Charge for Loan Provisions

Chart IX 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 Q1 2011 totalled BD\$6.5m, compared to BD\$24.4m in Q4 2010 and \$6.0m in Q1 2010.
- The annualised proportion of net charge-off to total loans decreased quarter-on-quarter from 1.1% in Q4 2010 to 0.3% in Q1 2011.

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

Table VIII: Bermuda Money Supply (Unconsolidated)

(BD\$ millions)	2011	2010			
		Dec	Sep	Jun	Mar
Notes and coins in circulation*	118	127	127	134	127
Deposit liabilities	3,448	3,660	3,706	3,719	3,748
Banks and deposit companies	3,566	3,787	3,828	3,853	3,875
Less: Cash at banks and deposit companies	62	65	60	73	61
Bermuda dollar money supply	3,504	3,722	3,768	3,780	3,814
% Growth on previous period	-5.87	-1.22	-0.32	-0.89	-2.4
% Growth year-on-year	-8.14	-4.73	-3.90	-2.64	-1.4

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

- The Bermuda money supply decreased by 5.8% during the quarter and by 8.1% year-on-year.

SELECT INTERNATIONAL DEVELOPMENTS

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

Bank for International Settlements (BIS) publications

In May, the BIS released its working paper no. 345 entitled, “The bank lending channel: lessons from the crisis”. This paper covers the new findings of the function of banks’ lending channels and the factors that led to the changes in banks’ business model, and its impact on the supply of credit and market funding patterns. The paper also looks at a more forward-looking approach to the statistical data coverage of the banking sector by central banks.

In March, the BIS issued its Quarterly Review “International banking and financial market developments”. The Review covers the impact on the economy from rising inflationary prices and commodities, and highlights the international banking market in the third quarter of 2010 by providing a perspective on the exposures of national banking systems to particular countries and sectors. The Review also identifies simple indicators for measuring systemically important financial institutions.

The BIS also issued its publication, “Macroprudential tools and policy framework” in March. This is an update summarising the work underway internationally and nationally to develop effective macroprudential policies and frameworks, by drawing also on surveys conducted by the BIS (via the Committee on the Global Financial System) and International Monetary Fund. These efforts include regulatory reforms and the design of policy tools to strengthen the resilience of the financial system, as well as efforts at the national and regional level to develop fully-fledged macroprudential policy frameworks.

The BIS also released its working paper no. 342 entitled, “Measuring the systemic importance of interconnected banks” in March. This paper provides a conceptual framework for analysing the relationship between interconnectedness and systemic importance and investigates this relationship empirically. Two approaches are used to measure the systemic importance of banks’ participation in systemic events and their contribution to systemic risk.

The Financial Stability Board (FSB) developments

In April, the FSB released its report, “Progress in the implementation of the G20 recommendations for strengthening financial stability”. This report provides an overview of the current work to implement the G20 recommendations for strengthening financial stability. It focuses on international policy development and implementation that has taken place since the G20 Finance Ministers and Governors meeting in February 2011.

The FSB published, in April, its note entitled, “Shadow banking: Scoping the issues”. It covers the work of the FSB to develop recommendations to strengthen the oversight and regulation of the shadow banking system. The financial crisis has revealed that shadow banking can be a source of systemic risk both directly and through its interconnectedness with the regular banking system.

Other developments

In April, the European Banking Authority adopted a benchmark for core Tier 1 capital to assess banks partaking in the European Union (EU) wide stress test exercise. The definition will be used solely for the purpose of the EU-wide stress testing and refers to specific criteria which will be applied consistently across all countries participating in the exercise.

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.

Annualised is expressing (a quantity such as an interest rate, profit, expenditure etc.) as if it applied or were measured over one year.

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.