Quarterly Banking Digest

Q2 2011

HIGHLIGHTS

- The aggregate risk asset ratio of Bermuda banks increased during Q2 2011, which remains above 21% and higher than comparable international standards.
- Total assets rose by 5.3% for the quarter resulting from increases in deposits with other financial institutions (up 19.1%).
- Profitability remains flat for the quarter as return on equity (ROE) was 8.8% and return on assets (ROA) was 1.1 %.
- The foreign currency share of banks' balance sheets continues to grow. Both FX-denominated customer deposits and assets each increased by 7.4% during the quarter, which is the largest increase over the past four quarters.
- Customer deposits increased during the quarter by 6.0%, resulting from growth in USD demand deposits (up 16.5%) and other FX currency saving deposits (up 23.8%).
- Lending has slowed but non-performing loans increased to 6.7% of total loans during the last quarter, while net charge offs slightly rose from 0.3% to 0.8% of total lending. Provisioning still remains below the annual average of 2010 and stands at 19.2% of NPLs.

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		
	Jun	Mar	Dec	Sep	Jun
Capital Position					
Risk Asset Ratio	21.8	21.3	25.6	25.0	21.0
Asset to Regulatory Capital Multiple	10.1	9.9	8.2	7.8	9.7
Equity to Total Assets	12.0	12.4	12.4	13.1	12.5
Profitability					
Interest margin to interest income	87.0	84.8	83.6	83.5	82.6
Return on assets	1.1	1.1	0.6	0.8	1.1
Return on equity	8.8	8.8	4.5	6.1	8.8

Table I: Selected Indicators (Part II)

(Ratios in percentages)	2011		2010		
	Jun	Mar	Dec	Sep	Jun
Loan Book					
Provisions to Non-Performing Loans (NPLs)	19.2	20.8	18.8	36.1	53.9
NPLs to total loans	6.7	5.4	5.7	3.7	3.4
NPLs to capital	24.6	20.4	17.2	11.1	12.5
Other					
BD$ money supply growth	0.4	-5.9	-1.2	-0.4	-0.9
Asset growth rate	5.3	-1.2	4.9	-2.2	3.9
Customer deposits growth rate	6.0	-0.5	5.4	-2.6	3.7
FX denominated deposits to total deposits	82.0	80.9	81.7	80.4	80.9
Loans to deposits	42.7	44.9	44.0	45.2	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 (%)	
	Jun	Mar	Dec	Sep	Jun	QoQ	YoY
Assets							
Cash	0.1	0.1	0.1	0.1	0.1	5.3%	-1.7%
Deposits	8.0	6.7	7.2	6.4	6.6	19.1%	20.3%
Loans & Advances	8.9	8.9	8.6	8.4	8.7	0.7%	2.2%
Investments	6.5	6.6	6.4	6.3	6.2	-0.9%	4.8%
Other Assets	1.0	1.1	1.1	1.1	1.1	-4.2%	-6.3%
Total Assets	**24.5**	**23.3**	**23.4**	**22.3**	**22.8**	**5.3%**	**7.8%**
Liabilities							
Savings Deposits	5.3	4.9	4.8	4.8	4.6	8.7%	16.3%
Demand Deposits	8.9	8.1	8.1	7.3	8.0	10.4%	10.6%
Time Deposits	6.7	6.7	6.7	6.6	6.5	-1.6%	2.5%
Total Deposits	**20.9**	**19.7**	**19.6**	**18.6**	**19.1**	**6.0%**	**9.2%**
Other Liabilities	0.4	0.4	0.5	0.4	0.5	2.6%	-18.9%
Total Liabilities	**21.3**	**20.1**	**20.2**	**19.1**	**19.7**	**5.9%**	**8.5%**
Equity and Subordinated Debt	3.2	3.1	3.2	3.2	3.1	2.2%	3.3%
Total Liabilities and Equity	**24.5**	**23.1**	**23.4**	**22.3**	**22.8**	**5.3%**	**7.8%**

Totals may not add due to rounding.

- Total assets increased by 5.3% during the quarter and 7.8% year-on-year.
- Within this aggregate, deposits with other financial institutions rose by 19.1% during the quarter and 20.3% year-on-year. Investments decreased slightly by 0.9% in Q2 but overall were up by 4.8% year-on-year.
- Total customer deposits increased during the quarter by 6.0% and 9.2% year-on-year, driven by USD demand deposits (up 16.5%) and other FX currency saving deposits (up 23.8%). Over the last three quarters customer deposits have shown noticeable movement primarily in USD 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)	2011		2010		
	Jun	Mar	Dec	Sep	Jun
Asset Allocation					
Investments	26.6	28.3	27.3	28.1	27.4
Loans	36.3	38.0	36.9	37.8	38.3
Deposits	32.5	28.7	30.8	28.9	29.1
Deposits Allocation					
Savings	25.5	24.8	24.5	25.7	23.9
Demand	42.5	40.8	41.4	39.1	42.0
Time	32.0	34.4	34.1	35.2	34.0
Capital Position					
Risk Asset Ratio	21.8	21.2	25.6	25.0	21.0
Equity to Total Assets	12.0	12.3	12.4	13.1	12.5
Asset to Regulatory Capital Multiple	10.1	9.9	8.2	7.8	9.7
Loan Book					
NPLs to total loans	6.7	5.4	5.7	3.7	3.4
Provisions to NPLs	19.2	20.8	18.8	36.1	53.9
Provisions to total loans	1.3	1.1	1.1	1.3	1.8

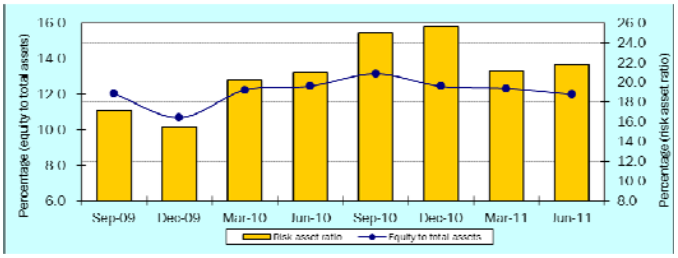
Totals may not add due to rounding.

- The proportion of assets allocated to investments decreased from 28.3% in Q1 2011 to 26.6% in Q2 2011.
- Deposits with other banks increased from 28.7% in Q1 2011 to 32.5% in Q2 2011.
- Provisions rose by 14.0% in Q2 2011 while NPLs increased by 23.6%. As a result, there was a decline in the overall ratio of provisions to NPLs from 20.8% in Q1 2011 to 19.2% in Q2 2011.
- NPLs to total loans increased from 5.4% in Q1 2011 to 6.7%, reflective of the increase in NPLs (up 23.6%) during the quarter as compared to a slight decrease in total loans (down 0.7%).

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



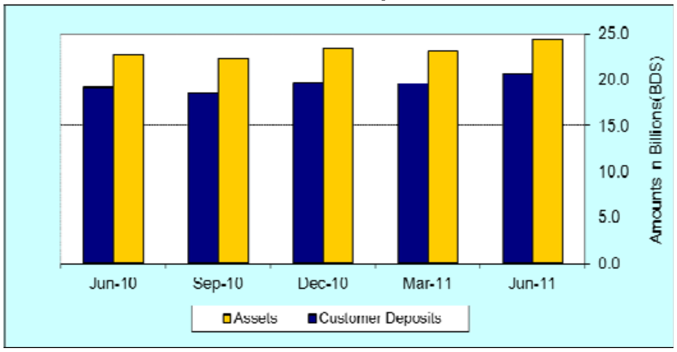
- The aggregate risk asset ratio rose to 21.8% in Q2 2011 from 21.3% from the previous quarter, though a marginal improvement it is still fairly high when compared to other international standards.

- The equity to total assets ratio decreased slightly to 12.0% 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 increased during the quarter from BD$23.3 billion to BD$24.5 billion. The increase was mainly driven by the rise in deposits with other financial institutions of 19.1%.

- Total customer deposit liabilities also rose from BD$19.7 billion to BD$20.9 billion (up 6.0%) and 8.2% year-on-year.

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		
	Jun	Mar	Dec	Sep	Jun
Loans and advances quarter-over-quarter growth rate	0.7	2.7	2.5	-3.5	3.7
Mortgages on residential property to total loans	52.8	52.4	51.9	53.3	51.1
BD$ denominated loans to total loans	58.7	59.3	58.2	59.4	60.1
Non-Performing Loans					
NPLs to total loans	6.7	5.4	5.7	3.7	3.4
NPLs to capital	24.7	20.5	17.2	11.1	12.5
Net charge-offs to loans	0.8	0.3	1.1	0.8	0.4
Provisioning Practices					
Provisions to NPLs	19.2	20.8	18.8	36.1	53.9
Provisions to total loans	1.3	1.1	1.1	1.3	1.8

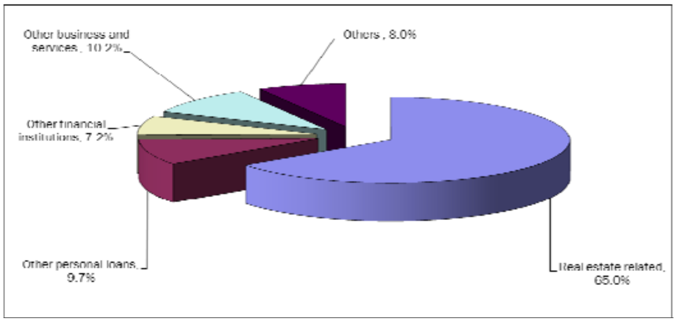
- The proportion of performing loans to total loans declined during the quarter from 94.6% to 93.3%.

- Net charge offs amounted to 0.8% of total loans, up from the previous quarter of 0.3%.

Sectoral Distribution of Loans

Chart III below shows the sectoral distribution of loans as at 30th June 2011.

Chart III: Sectoral Distribution of Loans and Advances



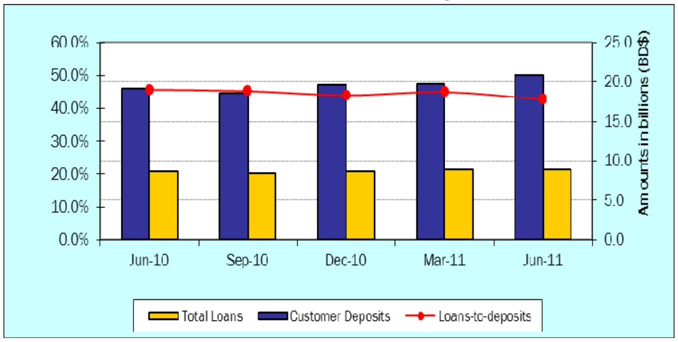
- The loan book continued to be dominated by real estate-related exposure, reported at 65.0% (Q1 2011: 65.4%) of total loans and advances in Q2 2011.

- Other personal loans decreased from 10.1% to 9.7% during the quarter, which has steadily declined over the last five quarters while 'other' loans increased by 8.0% (up from 6.9% in Q1 2011).

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.

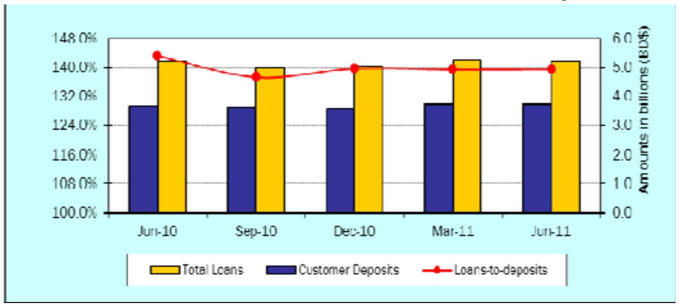
Chart IV: Total Loans and Customer Deposits



- Lending has slowed down relative to deposit inflows. Loans and advances increased by 0.7% during the quarter while total customer deposits increased by 6.0%. As a result, the loan-to-deposit ratio declined during the quarter from 44.9% to 42.7%. The decline is mainly attributed to a faster increase in FX currency customer deposits (up 7.4%) as compared to the increase in loans and advances (up 0.7%).

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

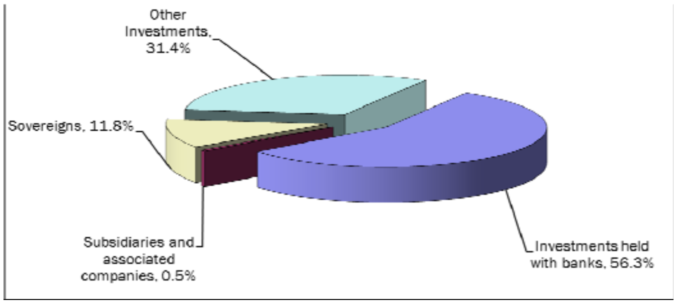


- The Bermuda dollar loans-to-deposits ratio remained at 139.6% for the second consecutive quarter and down from 143.3% a year earlier.

Investment Book

Chart VI below shows the structure of the aggregate investment book as at 30th June 2011.

Chart VI: Structure of the Investment Book



- Investments held with banks rose to 56.3% of total investments, up from 55.1% in Q2 2011, while 'sovereigns' decreased from 12.4% to 11.8%.

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		
	Jun	Mar	Dec	Sep	Jun
FX denominated assets to total assets	75.9	75.0	75.7	74.6	74.0
FX denominated loans to total loans	41.3	40.7	41.8	40.6	39.9
FX denominated deposits to total deposits	82.0	80.9	81.7	80.4	80.9
Changes in FX assets	7.4	-2.0	6.5	-1.5	3.8
Changes in FX loans and advances	2.1	0.2	5.4	-2.0	3.8
Changes in FX customer deposits	7.4	-0.4	7.0	-3.1	5.1

- The foreign currency share of banks' balance sheets continues to grow. Both FX denominated customer deposits and assets each increased by 7.4% during the quarter, which is the largest increase over the past four quarters. Non-resident foreign currency deposits have risen but remain immaterial for domestic financial intermediation.

- FX denominated deposits to total deposits increased from 80.9% in Q1 2011 to 82.0%, which have grown steadily over the last three quarters. These deposits fund about one third of domestic currency lending.

- Foreign currency lending to non-residents is more than twice as a high as foreign currency lending to residents. This gap has widened by 3.2% over the last quarter.

- US dollar assets made up 47.1% (Q1 2011: 46.5%) 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 (%)	
	Jun	Mar	Dec	Sep	Jun	QoQ	YoY
Loans and Advances	5.2	5.3	5.0	5.0	5.2	-0.4	-3.4
Total Assets	5.9	6.0	5.7	5.7	5.9	-0.7	-3.2
Deposit Liabilities	3.8	3.8	3.6	3.6	3.7	-0.3	–2.5
Equity and Subordinated Debt	2.1	2.0	2.1	2.1	2.1	1.9	2.4

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

- The shortfall of local currency funding continues to be offset by foreign currency-denominated deposits (mostly U.S. dollars) by residents.

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		
	Jun	Mar	Dec	Sep	Jun
Interest margin to interest income	87.0	84.2	83.6	83.5	82.6
Interest margin to total income	57.2	54.6	54.6	52.3	45.2
Non-interest expenses to total income	66.1	69.1	75.6	74.5	68.4
Personnel expenses to non-interest expenses	57.8	56.9	54.3	55.5	57.2
Return on assets (ROA)	1.1	1.1	0.6	0.8	1.1
Adjusted ROA	1.1	1.2	0.6	0.8	1.1
Return on equity (ROE)	8.8	8.8	4.5	6.1	8.8
Adjusted ROE	8.8	8.8	4.5	6.1	8.8
Interest income to earning assets	2.9	2.7	2.6	2.6	2.5
Interest expenses to customer deposits	0.4	0.5	0.5	0.5	0.5

Margin Analysis

- The interest margin to interest income was 87.0% in Q2 2011, up from 84.2% in Q1 2011 and 82.6% in Q2 2010. The improvement is a result of the sector's growth in interest income (up 7.3%) compared to the decline in interest expense (down 8.2%).

- The quarter-on-quarter decrease in non-interest expenses to total income from 69.1% to 66.1% was a result of an increase in total income of 4.9% compared to a slight increase in total operating expenses of 0.3%.

Profitability Ratios

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

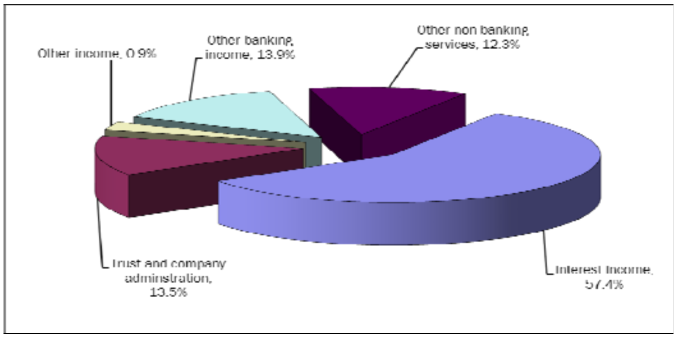
Chart VII: Annualised Return on Assets and Return on Equity

- During the quarter ROE and ROA remained flat at 8.8% (Q1 2011: 8.8%) and 1.1% (Q1 2011: 1.1%), respectively.

Distribution of Income Sources

Chart VIII below shows the distribution of income sources for the year ended 30th June 2011.

Chart VIII: Distribution of Income Sources

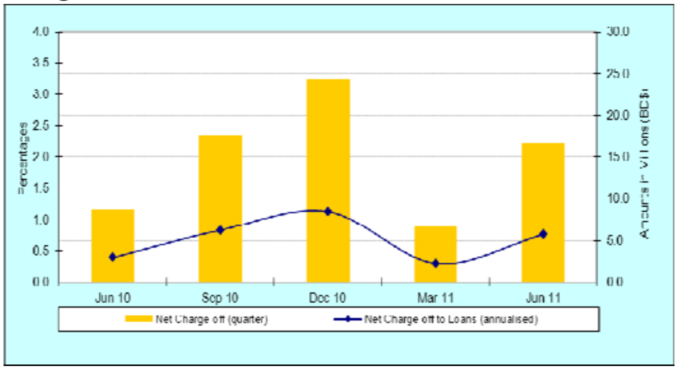


- Interest income contributed 57.4% (Q1 2011: 54.6%) of total income while the share of 'other banking income' declined from 16.0% in Q1 2011 to 13.9%. Income from non-banking services made up 26.7% (Q1 2011: 29.4%) of total income.

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 Q2 2011 totalled BD$16.7m, compared to BD$6.7m in Q1 2011 and $8.7m in Q2 2010 for the sector.

- The annualised proportion of net charge-off to total loans increased quarter-on-quarter from 0.3% in Q1 2011 to 0.8% in Q2 2011.

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

Table VIII: Bermuda Money Supply (Unconsolidated)

	2011		2010		
(BD$ millions)	Jun	Mar	Dec	Sep	Jun
Notes and coins in circulation*	121	118	127	127	134
Deposit liabilities	3,641	3,637	3,660	3,706	3,719
Banks and deposit companies	**3,762**	**3,755**	**3,787**	**3,828**	**3,853**
Less: Cash at banks and deposit companies	62	62	65	60	73
Bermuda dollar money supply	**3,700**	**3,504**	**3,722**	**3,768**	**3,780**
% Growth on previous period	0.18	-0.78	-1.22	-0.32	-0.89
% Growth year-on-year	-2.13	-3.17	-4.73	-3.90	-2.64

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

- The Bermuda money supply increased slightly by 0.2% during the quarter and decreased by 2.1% year-on-year.

SELECT INTERNATIONAL DEVELOPMENTS

This section lists important publications by international organisations and national authorities during the last 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)

In July, the BIS released a consultative document entitled. "Globally Systemic Important Banks: Assessment Methodology and Additional Loss Absorbency Requirement." The documents sets out the proposal from the Basel Committee on the assessment methodology for global systemic importance, the magnitude of additional loss absorbency that global systemically important banks should have and the arrangements by which they will be phased in.

http://www.bis.org/publ/bcbs201.pdf

The BIS also released its latest document entitled "Basel III Definition of Capital - Frequently Asked Questions." The document addresses frequently asked questions and published responses along with any technical elaboration of the BASEL III rules text. The questions and answers are grouped according to the relevant paragraphs of the rules text.

http://www.bis.org/publ/bcbs198.pdf

In June, the BIS released a paper entitled "Principles for the Sound Management of Operational Risk and the Role of Supervision." This paper is an update to the 2003 Sound Practices paper, which provides enhancements to sound operational risk management practices now in use by the industry. It incorporates the evolution of sound practice and details eleven principles of sound operational risk management covering (1) governance, (2) risk management environment and (3) the role of disclosure.

http://www.bis.org/publ/bcbs195.pdf

The BIS also released a paper entitled "Operational Risk—Supervisory Guidelines for the Advanced Measurement Approaches." In the paper the Basel Committee's Standards Implementation Group, through its Operational Risk Subgroup (SIGOR) addresses challenges with the successful development, implementation and maintenance of an AMA framework. The paper identifies supervisory guidelines associated with the development and maintenance of key internal governance, data and modelling frameworks underlying an AMA.

http://www.bis.org/publ/bcbs196.pdf

The BIS issued its Quarterly Review for June 2011, entitled, "International Banking and Financial Market Developments." The report discusses the reassessment of growth and inflation prospects in the advanced economies, as well as euro area sovereign debt concerns, drove asset prices, rating methodologies for banks and expansion for central clearing.

http://www.bis.org/publ/qtrpdf/r_qt1106.pdf

Financial Stability Board (FSB)

In June, the FSB released a report updating the progress made by the FSB and International Monetary Fund (IMF) in implementing the 20 recommendations in the report "The Financial Crisis and Information Gaps." The report addresses high priority items like the build-up of risks in the financial sector and financial interconnectedness (domestic and cross-border).

http://www.financialstabilityboard.org/publications/r_110715.pdf

Other developments

In August, the UK Financial Services Authority (FSA) published a consultation and discussion paper version of its proposal on Recovery and Resolution Plans (RRP) required for financial institutions. The CP covers the requirement for banks and large investment firms in the UK to prepare and maintain recovery and resolution plans and the DP explores matters relevant to the resolution of financial services firms.

http://www.fsa.gov.uk/pubs/cp/cp11_16.pdf

In July, the Committee on the Global Financial System, released a paper on "The impact of Sovereign Credit on Banking Funding Conditions." This report examines the relation between sovereign credit risk and bank funding conditions, how banks might respond to an environment of ongoing elevated sovereign risk, and the implications for policy makers.

http://www.bis.org/publ/cgfs43.pdf

In July, the European Banking Authority (EBA) published its summary report "European Banking Authority 2011 EU-wide stress test aggregate report." The objective, carried out by the EBA along with national supervisors across 90 banks in 21 countries, was to assess the resilience of a large sample of banks in the EU1 against an adverse but plausible scenario.

http://stress-test.eba.europa.eu/pdf/EBA_ST_2011_Summary_Report_v6.pdf

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.