BMA

BERMUDA MONETARY AUTHORITY

Regulatory Update April - June 2016

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Preface

This bulletin reports on recent activities at the Bermuda Monetary Authority (the Authority) and recent developments affecting the financial sector, as well as the community generally. Attached to it is the regular statistical data covering Bermuda Dollar money supply, Bermuda banks' balance sheet analysis, and other financial and company sector information updated for the quarter ended 30th June 2016.*

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Quarterly Synopsis

The capital position of Bermuda's banks remained strong over the second quarter. This was helped by the recent introduction of a new Capital Conservation Buffer (CCB), as well as higher capital levels introduced under Basel III. Profitability improved while total assets fell. Loan book quality remained positive, with the percentage of Non-Performing Loans (NPLs) to total loans falling for the fourth consecutive quarter. Increased losses impacted Bermuda's (re)insurance sector for the second consecutive quarter, resulting in a higher loss ratio and lower quarterly profits compared a year earlier. Bermuda's financial sector continues to operate against the background of a global economy that is slowly recovering. At the end of the quarter, the largely unexpected outcome of the Brexit referendum led to an immediate increase in volatility in international financial markets, although by July the impact on financial markets had largely dissipated. A positive factor for the financial sector is that Bermuda's economy continued to show signs of improvement – Gross Domestic Product (GDP) at current prices has increased over the past 18 months.

The banking sector's capital levels increased slightly during the quarter, preserving the overall capital position. The Basel III Risk Asset Ratio (RAR) rose marginally from 21.0% to 21.4%, higher than levels reported a year ago (18.6%). The primary capital adequacy measure of Common Equity Tier 1 (CET 1) had a modest increase, rising to 17.8%. As of 1st January 2016, banks were required to hold an additional buffer of capital above the regulatory minimum requirement per the new phased-in CCB, raising the minimum CET 1 from 4.5% to 5.1%. Leverage rose marginally to 7.7%. Total assets fell by 1.3%, 3.0% lower year-on-year. The overall quarterly decline was attributed to a planned business sale, resulting in a decline in investment holdings (down 19.8%), which offset an increase in loans (up 3.4%) and interbank deposits (up 35.2%).

Bank profitability continued to build with higher earnings and reasonably stable operating costs. The banking sector posted higher quarterly earnings, led by non-banking income (up $19.9 million or 67.6%), while the majority of other sources of income remained comparatively steady. Overall total income levels rose by 9.7%, while operating expenses were relatively stable. Non-operating expenses mainly associated with net charge-offs, rose by $3.5 million (or 66.6%) for the quarter. Overall cost efficiency improved for a second consecutive quarter, as non-interest expenses to total income fell from 66.5% to 62.5%. Improved sector profits resulted in higher returns, as annualised Return on Equity (RoE) and Return on Assets (RoA) increased to 15.2% and 1.4%, respectively. Loan book quality remained positive, with NPLs as a percentage of total loans falling to 7.2% during the second quarter. Banks wrote-off $8.7 million of uncollectible loans, $1.6 million (or 31.8%) lower than amounts written-off a year earlier.

Banking sector liquidity conditions continued to improve over the past year. The sector's liquidity funding structure remained positive with the ratio of loans to total deposits rising for a fourth consecutive quarter, from 43.9% to 45.9%. Loan growth continued to outpace growth in customer deposits, causing a further narrowing in the sector's funding gap. While overall lending was positive, lending to the real-estate sector declined to 36.7% of total loans. Lending to sectors classified as "Other" increased from 30.2% to 36.4% of total loans due to increased lending to low-risk, highly-rated sovereigns. All other remaining sectors experienced minimal declines during the quarter. At the end of Q2-2016, all banking institutions were in compliance with the new 70.0% phased-in Liquidity Coverage Ratio (LCR) as per the Authority's Basel III Final Rule and regulatory liquidity requirements.

The BD$ money supply rose by 1.3% during the second quarter, 2.8% higher than the previous year. The net increase in local money supply was generated by an increase in customer deposits (up 1.2% or $42.1 million) and physical notes and coins in circulation (up 3.0% or $3.7 million) during the period.

Total market capitalisation of the Bermuda Stock Exchange (BSX) (excluding funds) was down 1.1% (or $3.3 billion), falling to $285.8 billion at the end of Q2-2016. This decrease was primarily due to changes in the trading values of several large, international companies. Total trading volume in Q2-2016 was 4,315,612 shares (up from 2,733,142 shares in the previous quarter), with a corresponding total market value of $11.1 million (up from $6.4 million in Q1-2016). The market capitalisation of Insurance Linked Securities (ILS) on the BSX stood at $18.3 billion, representing 73.0% of the global stock of outstanding ILS deals.

The (re)insurance industry experienced lower profits in Q2-2016 compared to Q2-2015, as catastrophic events combined with low investment returns negatively impacted the sector's net income levels. Bermuda's (re)insurance groups were hit with higher losses in Q2-2016 compared to a year earlier, resulting in the combined ratio increasing by 6.9% to 97.2%. The overall asset base improved by 4.0% over the same period, while (re)insurers were able to produce positive gross profits of $1.0 billion, 31.1% lower than amounts reported by (re)insurance groups one year ago. The investment portfolio of Bermuda's (re)insurance groups generated low returns – Return on Investments (RoI) was at 0.6%, while RoE declined to 1.5% when compared to a year ago. Given predictions for an above-normal hurricane season, (re)insurers will closely watch what impact this will have on future results.

The outlook for global economic growth remains tilted to the downside due to ongoing adjustments – several indicators point to slow growth in most major economies. Further risks include: slower than expected growth in major emerging and developing economies; heightened uncertainty about the EU and the UK as a result of the Brexit referendum in late June; and sluggish growth in the US and China.

During the quarter, Bermuda's Department of Statistics released GDP data for Q1-2016 which showed a mild overall improvement (+0.6%) at current prices, but growth was negative (-0.6%) at constant prices. The main drivers of nominal growth were a $29.2 million increase in household consumption (3.8% increase compared to Q1-2015) and a $21.5 million increase in construction (24.2% increase compared to Q1-2015). In contrast, a $21.6 million rise in payments related to imports of goods and services contributed negatively to GDP growth (5.1% increase compared to Q1-2015).

A) BERMUDA MONEY SUPPLY

The banking sector's money supply rose by 1.3% (or $44.9 million), representing the third quarter of consecutive increases. A rise in deposit liabilities was the main driver of the money supply having increased by 1.2% (or $42.1 million) over the prior quarter. When compared to the previous year, overall money supply had risen by 3.6% (or $122.1 million). Deposit liabilities rose by 3.6% (or $118.6 million) from the previous year.

Bermuda Money Supply

(BD$ mln)	Q2-2016	Q1-2016	Q4-2015	Q3-2015	Q2-2015	Q1-2015
Notes & Coins in Circulation*	129	125	133	124	122	118
Deposit Liabilities	3,458	3,416	3,359	3,333	3,340	3,329
Total	**3,587**	**3,541**	**3,492**	**3,457**	**3,462**	**3,447**
Less: Cash at Banks and Deposit Companies	39	38	45	38	36	33
BD$ Money Supply	3,548	3,503	3,447	3,419	3,426	3,414
% Change on Previous Period	1.28%	1.63%	0.84%	-0.22%	0.36%	2.14%
% Change Year-on-Year	**3.56%**	**2.25%**	**3.14%**	**1.33%**	**2.02%**	**-1.91%**

Totals may not add due to rounding.

* *This table denotes the supply of Bermuda Dollars only. United States currency is also in circulation in Bermuda but the amount has not been quantified.*

B) DOMESTIC AND FOREIGN CURRENCY POSITION

BD$ Deposit and Loan Profile – Combined Banks and Deposit Companies (Unconsolidated)

(BD$ mln)	Q2-2016	Q1-2016	Q4-2015	Q3-2015	Q2-2015	Q1-2015
Deposit Liabilities	3,458	3,416	3,359	3,333	3,340	3,329
Less: Loans, Advances and Mortgages	(3,876)	(3,915)	(3,971)	(3.975)	(4,125)	(4,188)
Surplus/(deficit) Deposits	(418)	(499)	(611)	(643)	(785)	(859)
Percentage of Deposit Liabilities Loaned	**112.1%**	**114.6%**	**118.2%**	**119.3%**	**123.5%**	**125.8%**

Totals may not add due to rounding.

The deficit continued to decline during the quarter, down 16.2% (or $80.9 million) as a reduction in loan balances was offset by growth in the sector's deposit base. As a result, the loan-to-deposit ratio fell from 114.6% to 112.1%. The improvement in the ratio was the result of 1.2% (or $42.1 million) growth in domestically-denominated deposit liabilities while the domestic loan book fell 1.0% (or $38.8 million). In comparison to a year earlier, the movement within the ratio was amplified largely by a 6.0% (or $248.8 million) decline in the sector's loan portfolio. Conversely, deposit liabilities were up 3.6% (or $118.6 million) from a year earlier.

Foreign Currency Position - Combined Banks and Deposit Companies (Consolidated)

(BD$ mln)	Q2-2016	Q1-2016	Q4-2015	Q3-2015	Q2-2015	Q1-2015
Total Foreign Currency Assets	19,597	19,904	19,715	19,009	20,091	19,459
Less: Other Assets	255	162	183	201	212	218
Less: Foreign Currency Loans to Residents	1,073	1,089	999	944	825	873
Net Foreign Currency Assets	18,269	18,653	18,533	17,864	19,054	18,368
Foreign Currency Liabilities	17,860	18,239	18,313	17,644	18,804	18,166
Add: BD$ Deposits of Non-Residents	154	155	116	193	174	172
Net Foreign Currency Liabilities	18,013	18,394	18,429	17,837	18,978	18,338
Net Foreign Currency Position	**256**	**259**	**104**	**27**	**76**	**30**

Totals may not add due to rounding.

The net foreign currency position remained positive despite moderate declines of approximately $3 million during quarter.

C) BANKING

Banking Sector Assets and Deposits

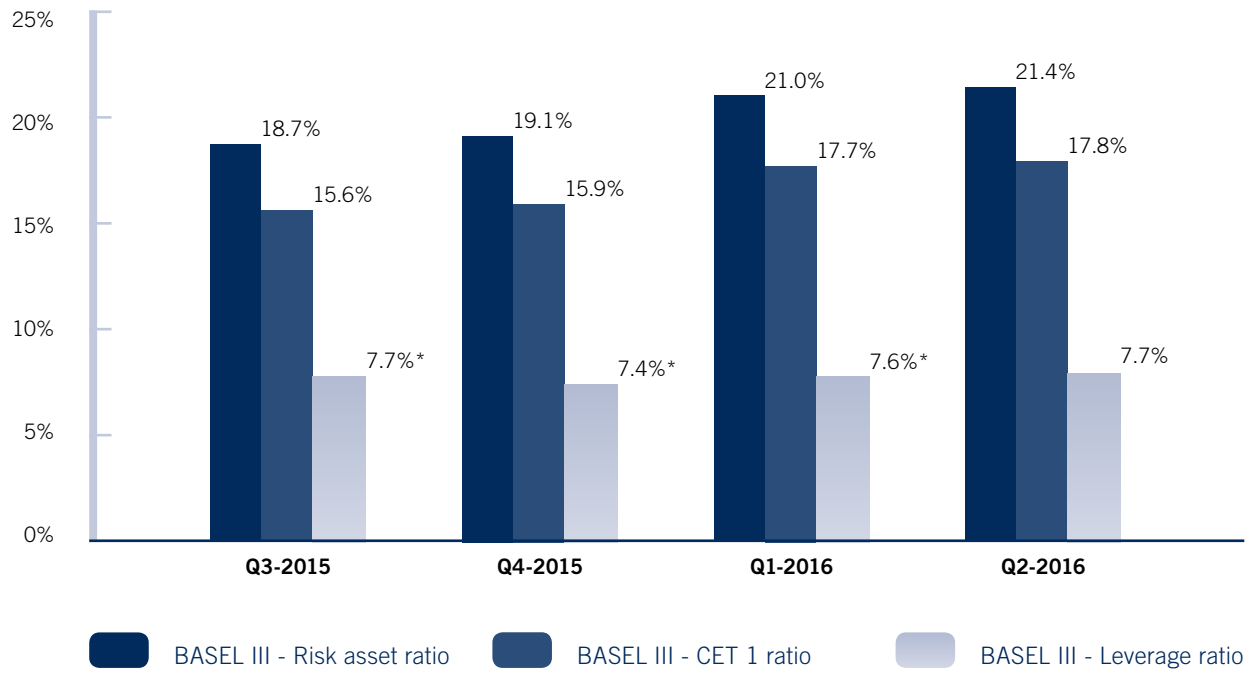
(BD$ mln)	Q2-2016	Q1-2016	Q4-2015	Q3-2015	Q2-2015	Q1-2015
Total Assets	23,901	24,206	24,072	23,416	24,631	24,097
Quarterly Change (%)	-1.3%	0.6%	2.8%	-4.9%	2.2%	4.4%
Total Deposits	21,051	21,275	21,365	20,662	22,052	21,378
Quarterly Change (%)	-1.1%	-0.4%	3.4%	-6.3%	3.2%	5.1%

The sector's asset base fell by 1.3% (or $305 million) while deposit liabilities fell by 1.1% (or $1.0 billion) during the same period. The decline in the asset base was driven by investment holdings which fell by 19.8% (or $2.1 billion) during the quarter. Conversely, interbank deposits increased by 35.2% (or $1.3 billion) as did loans by 3.4% (or $320.0 million).

When compared to a year earlier, deposit liabilities decreased by 4.5% (or $1.0 billion) while total assets fell by 3.0% (or $730.0 million).

Basel III Ratios

The sector's risk asset ratio under Basel III rose from 21.0% to 21.4% during the second quarter of 2016.



* *Restated*

RAR	Period	Tier I RAR	RAR Change
21.4%	**Q2-2016**	**17.8%**	**0.4%**
21.0%	**Q1-2016**	**17.7%**	**1.9%**
19.1%	**Q4-2015**	**15.9%**	**0.4%**
18.7%	**Q3-2015**	**15.6%**	**0.1%**

Basel III adoption became effective 1st January 2015 with a phasing-in period for capital requirements commencing from 2016 to 2019 (full implementation). Basel II reporting was discontinued from 1st January 2016.

Beginning 1st January 2016, the phased-in Basel III Liquidity Coverage Ratio (LCR) requirement was 70.0%, an increase from 60.0% (2015 requirement). A fully phased-in LCR minimum of 100.0% will be in place by 1st January 2019.

As of 1st January 2016, all banks were required to hold additional capital until 1st January 2019 due to the phasing-in of the Capital Conservation Buffer (CCB). This year, the phase-in requirement is 0.6% which resulted in the minimum CET 1 ratio increasing from 4.5% to 5.1%. The 2019 fully phased-in CCB will be 2.5%.

The sector's capital position stays strong under the new Basel III standards. Capital adequacy levels remain well above the minimum regulatory requirements. The Basel III Risk Asset Ratio (RAR) increased from 21.0% to 21.4%, while the CET 1 ratio rose from 17.7% to 17.8% during the quarter. The leverage position under Basel III also increased slightly from 7.6% to 7.7%.

Combined Balance Sheet Of Bermuda Banks And Deposit Companies (Consolidated)

	Q2-2016			Q1-2016			Q4-2015		
(BD$ mln)	Total	BD$	Other*	Total	BD$	Other*	Total	BD$	Other*
Assets									
Cash	81	39	42	78	38	40	81	45	36
Deposits	5,072	31	5,040	3,750	30	3,720	3,813	25	3,788
Investments	8,290	38	8,253	10,338	35	10,303	10,425	39	10,386
Loans & Advances	9,660	3,762	5,897	9,340	3,802	5,538	9,073	3,862	5,211
Premises & Equipment	337	227	110	348	236	112	406	294	112
Other Assets	461	207	255	353	161	192	274	92	183
Total Assets	**23,901**	**4,304**	**19,597**	**24,206**	**4,302**	**19,904**	**24,072**	**4,357**	**19,715**
Liabilities									
Demand Deposits	11,453	1,085	10,368	11,372	1,130	10,242	11,668	1,049	10,619
Savings	6,465	1,524	4,941	7,060	1,536	5,524	6,493	1,489	5,004
Time Deposits	3,133	821	2,312	2,843	741	2,102	3,204	799	2,405
Sub Total - Deposits	**21,051**	**3,430**	**17,620**	**21,275**	**3,407**	**17,868**	**21,365**	**3,337**	**18,028**
Other Liabilities	590	351	239	731	360	371	567	281	286
Sub Total - Liabilities	**21,641**	**3,781**	**17,860**	**22,006**	**3,767**	**18,239**	**21,931**	**3,618**	**18,313**
Equity & Subordinated Debt	2,260	1,869	390	2,199	1,839	361	2,141	1,797	344
Total Liabilities and Capital	**23,901**	**5,650**	**18,250**	**24,206**	**5,606**	**18,600**	**24,072**	**5,415**	**18,657**

	Q3-2015			Q2-2015			Q1-2015		
(BD$ mln)	Total	BD$	Other*	Total	BD$	Other*	Total	BD$	Other*
Assets									
Cash	82	38	44	76	36	40	70	33	36
Deposits	4,919	21	4,898	5,891	40	5,851	5,332	48	5,284
Investments	9,185	40	9,145	9,277	58	9,219	9,431	51	9,380
Loans & Advances	8,520	3,919	4,600	8,665	4,017	4,648	8,496	4,081	4,415
Premises & Equipment	425	304	121	431	309	121	444	318	126
Other Assets	285	84	201	291	79	212	325	107	218
Total Assets	**23,416**	**4,406**	**19,009**	**24,631**	**4,540**	**20,091**	**24,097**	**4,638**	**19,459**
Liabilities									
Demand Deposits	11,101	1,021	10,080	12,151	1,021	11,130	11,393	1,002	10,391
Savings	6,035	1,487	4,548	6,199	1,495	4,704	6,395	1,503	4,892
Time Deposits	3,526	802	2,723	3,702	803	2,899	3,589	813	2,776
Sub Total - Deposits	**20,662**	**3,311**	**17,351**	**22,052**	**3,320**	**18,733**	**21,378**	**3,319**	**18,059**
Other Liabilities	585	291	293	400	329	71	392	285	107
Sub Total - Liabilities	**21,247**	**3,602**	**17,644**	**22,453**	**3,649**	**18,804**	**21,770**	**3,604**	**18,166**
Equity & Subordinated Debt	2,169	1,793	376	2,178	1,829	349	2,327	1,935	392
Total Liabilities and Capital	**23,416**	**5,395**	**18,021**	**24,631**	**5,478**	**19,153**	**24,097**	**5,539**	**18,558**

Premises and Equipment and Other Assets have been restated to reclassify equipment and other fixed assets that were previously recorded under Other Assets.

** Other includes USD and other currencies.*

D) BERMUDA STOCK EXCHANGE (BSX)

Total market capitalisation of the BSX (excluding funds) was $285.8 billion at the end of Q2-2016, down $3.3 billion from $289.0 billion recorded in Q1-2016. This decrease was primarily due to changes in the trading values of several large, international companies. Total trading volume in Q2-2016 was 4,315,612 shares (up from 2,733,142 shares in the previous quarter), with a corresponding total market value of $11.1 million (up from $6.4 million in Q1-2016). The valuation of domestic firms constituted 0.58% of the total market, with capitalisation amounting to $1.67 billion, down $62.4 million from the previous quarter.

At the end of Q2-2016, the market capitalisation of Insurance-Linked Securities (ILS) on the BSX stood at $18.3 billion, representing 73.0% of the global stock of outstanding ILS deals. At quarter-end, a total of 78 ILS deals (comprising 110 tranches) were listed on the BSX, with an aggregate nominal value of approximately $18.3 billion, of which $1.3 billion (or 5.0%) was attributable to six ILS deals originated by Special Purpose Insurers (SPIs) domiciled outside Bermuda. Global market capitalisation of ILS fell to $25.1 billion, as $1.6 billion in new issuances was outpaced by $3.0 billion in maturing bonds during the quarter.

Selected Stock Market Performance Indicators*

In % unless indicated otherwise

	Q2-2016	Q1-2016	Q4-2015	Q3-2015	Q2-2015	Q1-2015
Price Return[1/]						
BSX	-0.27	-3.29	2.43	0.81	-4.35	0.00
BSX - Insurance	-0.24	0.20	1.88	-0.27	0.64	0.42
DJII	0.88	-0.31	2.43	-3.03	-0.01	0.34
Return Volatility						
Annualised Standard Deviation[2/]						
BSX	3.26	3.60	3.14	2.65	1.69	2.28
BSX - Insurance	2.28	2.25	2.23	1.64	1.55	1.59
DJII	3.96	3.50	2.83	2.44	2.08	2.11
Normalised Squared Returns (in standard deviations)[3/]						
BSX	-0.14	0.83	0.92	0.10	2.09	-0.11
BSX - Insurance	-0.05	-0.02	0.06	-0.02	-0.11	-0.07
DJII	-0.22	5.90	1.97	0.82	-0.59	-0.42
Trading Volume/Market Capitalisation[4/]						
BSX	0.29	0.37	0.25	0.24	0.37	0.37
DJII	7.77	9.33	8.92	9.49	7.62	7.66
Real Dividend Yield[5/]						
BSX	2.62	2.23	1.89	1.83	1.43	1.70
DJII	1.54	1.60	2.02	2.35	2.32	2.29

Sources: Bloomberg, BSX and the Authority's staff calculations.

** The figures for the BSX and the BSX - Insurance cover the domestic listings only.*

Notes:
1/ Quarterly average of month-on-month change of last prices.

2/ Quarterly average of annualised standard deviation of month-on-month change of last prices.

3/ Quarterly average of the six-month moving average of squared month-on-month changes of last prices, normalised over a rolling window of four years (16 quarters); a positive (negative) value indicates above (below) average performance conditional on market volatility.

4/ Cumulative quarterly trading volume relative to the average market capitalisation during the same time period.

5/ Quarterly average of month-on-month dividend yield adjusted for headline inflation in Bermuda and the United States, respectively.

The overall performance of the BSX was negative during the quarter. The table (p.9) provides a summary of selected indicators of stock market performance over the last six quarters (Q1-2015 to Q2-2016), comparing the recent development of the BSX to that of the Dow Jones Industrial Index (DJII) as the global equity market benchmark (which proxies the impact of US capital market performance on Bermuda's international business sector). Over the last quarter, the BSX index recorded a negative return of -0.27% (up from -3.27% in Q1-2016) amid lower annualised volatility of 3.26% (down from 3.60% in Q1-2016), while trading volume fell to 0.29% of market capitalisation. Despite modest improvement in its risk-return trade-off, the BSX index underperformed global standards, relative to the DJII, which recorded a quarterly return of 0.88% (up from -0.31% in Q1-2016) amid higher annualised return volatility of 3.96% (up from 3.50% in Q1-2016). The risk-return trade-off was more favourable for the insurance sub-index (BSX-Insurance). The total return performance was -0.24% during the quarter (down from 0.20% in Q1-2016), while volatility modestly rose to 2.28 % (up from 2.28% in Q1-2016).

The following charts show the BSX quarterly closing levels (indexed to Q1-2005 as base year), the annualised return volatility, the dividend yield (in both nominal and real terms) and the trading volume up to Q2-2016 (Charts 1-4). While capital gains of the BSX have turned negative since the beginning of 2009, dividend pay-outs remain high and were above international markets for a second consecutive quarter. The aggregate dividend yield of stocks listed on the BSX over the last quarter stood at 2.62% (up from 2.23% in Q1-2016) after adjusting for headline inflation, which was higher than comparable yields generated by stocks included in the DJII (at 1.54%). At the same time, the annualised return volatility (as a measure of risk) was modestly higher than that of the DJII (but below the long-term average over the last four years, as indicated by the negative value of normalised squared returns in the table below).

Chart 1. Price Level, indexed (Q1-2005=100)

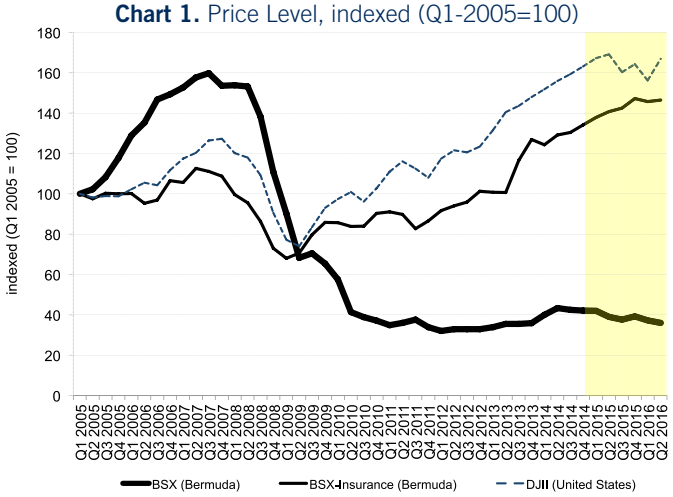


Chart 2. Annualised Return Volatility

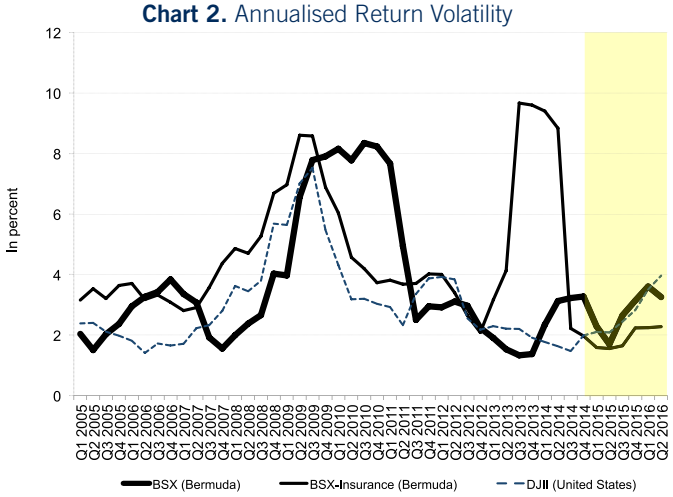


Chart 3. Dividend Yield (nominal and inflation-adjusted)

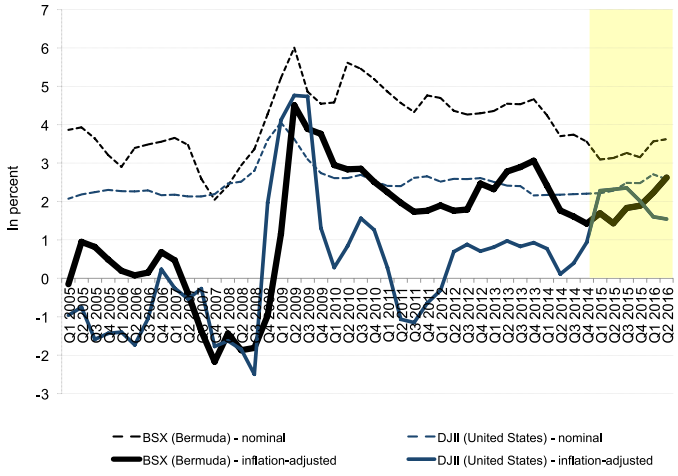
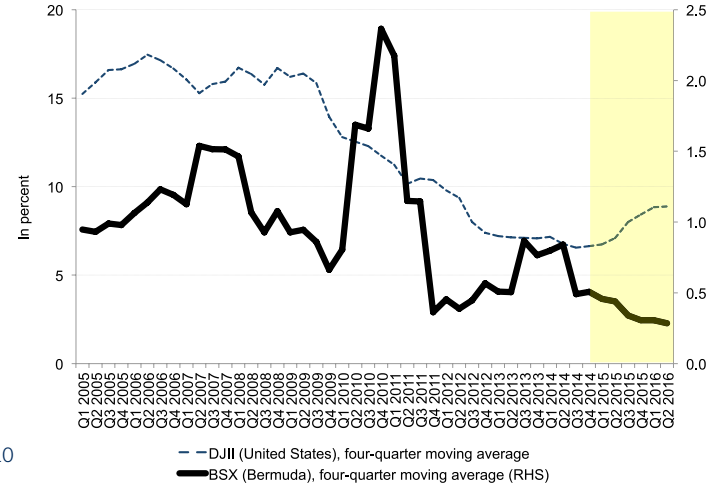


Chart 4. Ratio Between Trading Volume and Market Capitalisation



E) INVESTMENT FUNDS

Investment Fund Statistics

	Q2-2016	Q1-2016	Q4-2015	Q3-2015	Q2-2015	Q1-2015
Mutual Funds	415	419	429	434	434	433
Umbrella Funds	36	37	38	39	39	38
Segregated Accounts Companies (SAC)	69	68	69	70	69	69
Unit Trusts	44	43	52	50	49	50
Umbrella Trusts	28	29	36	37	37	37
Total Number of Funds	592	596	624	630	628	627
Net Asset Value (in US$ bln)	**$151.81**	**$150.19**	**$144.22**	**$145.06**	**$152.57**	**$166.65**

During the period Q2-2016 to Q1-2016, the total number of funds decreased by four while there was an increase in total Net Asset Value by 1.08% or $1.62 billion.

F) COMPANY AUTHORISATIONS

Companies, Partnerships and Permits Statistics - Applications Approved

	Q2-2016	Q1-2016	Q4-2015	Q3-2015	Q2-2015	Q1-2015
Exempted Companies (Bermuda companies exempted from the 60.0% Bermudian ownership requirement)	212	238	329	198	212	222
Exempted Partnerships (partnerships established in Bermuda to carry on business in or from within Bermuda)	47	28	38	17	36	18
Overseas Partnerships (overseas partnerships applying for permits to carry on business in or from within Bermuda)	1	1	8	5	2	2
Overseas Permit Companies (overseas companies applying for permits to carry on business in or from within Bermuda)	13	3	3	13	11	6
Unit Trusts	1	2	2	1	0	1
Total Applications Approved*	**274**	**272**	**380**	**234**	**261**	**249**

** Quarterly Numbers are amended to reflect more up-to-date consent information.*

The statistics shown above reflect the number of applications that have received vetting clearance from the Authority.

These figures do not reflect the actual number of entities incorporated in Bermuda during the period. Such statistics can be obtained from the Registrar of Companies.

G) INSURANCE

Insurance Registrations (Q2-2016)

During the second quarter of 2016, the Authority registered 14 insurers and three intermediaries. This compares to 20 insurers and six intermediaries for the same period last year.

Name	Date	Type
Registrations in April 2016		
SIGCo (IoM) Limited	4-Apr-16	3
Bellemeade Re II Ltd.	4-Apr-16	SPI
Signify Insurance Ltd.	13-Apr-16	1
Neon Underwriting Bermuda Limited	18-Apr-16	Agent
Operational Re Ltd.	22-Apr-16	SPI
IPPA Insurance Company, Ltd.	29-Apr-16	2
Registrations in May 2016		
Blue Jay Reinsurance Ltd.	16-May-16	SPI
First Coast Re Ltd.	25-May-16	SPI
Laetere Re Ltd.	25-May-16	SPI
Weddell (Bermuda) Re Limited	31-May-16	C
The Hanover Atlantic Insurance Company Ltd.	31-May-16	3A
Registrations in June 2016		
Blue Halo Re Ltd.	2-Jun-16	SPI
KL Insurance Ltd.	14-Jun-16	3
Travelers Insurance Company Limited	14-Jun-16	3A
AXIS Reinsurance Managers Limited	22-Jun-16	Manager
AXIS Reinsurance Managers Limited	22-Jun-16	Agent
Harrington Re Ltd.	22-Jun-16	4
Total Registrations		
Insurers: 14	Intermediaries: 3	

Descriptions of the various classes of insurer can be found in the Explanatory Notes section of this publication on page 19.

Quarterly Review of the Commercial (Re)insurance Sector – Bermuda (Re)insurance Groups (as of end Q2-2016)

The following section provides the main findings from a review of quarterly public US GAAP filings of (re)insurers that fall within group wide supervision by the Authority (Bermuda groups). These findings reflect general trends and developments of the sector in aggregate and do not imply changes in the supervisory assessment in relation to individual firm performance.

The second quarter of 2016 recorded higher losses for large commercial Bermuda (re)insurance groups[1] compared to Q2-2015, and the combined ratio increased by 6.9% q/q.[2] There were higher catastrophic losses, however, these were not of a scale that would cause severe disruptions to (re)insurers or change the pricing dynamics.

Monetary policy remains an important economic variable in (re)insurance, driving investment yields and financial disintermediation from traditional reinsurance to the securitised risk markets. Central banks remained accommodative and monetary policy did not change dramatically in Q2-2016. Pricing dynamics in the reinsurance market did not change significantly, and there were few catastrophic losses. It remains to be seen how the hurricane season will affect reinsurers' results given that meteorologists predict a more active season this year. In the catastrophe bond market, Q2-2016 net issuance volume decreased by $1.4 billion, while global outstanding volume reached $25.1 billion.

Bermuda (re)insurance groups improved their asset base by 4.0% q/q. Despite increased claims, Bermuda (re)insurers produced a positive gross profit of $1.0 billion, which was lower by 31.1% q/q due to higher losses and increased expenses. The aggregate combined ratio stood at 97.2% compared to 90.9% in Q2-2015. The loss ratio increased by 11.1% q/q due to higher losses while the expense ratio marginally decreased q/q despite an increase in the expenses as an absolute number. Investment income represented 82.7% of net income, an increase by 46.1% from Q2-2015. The main reason for the increase in the ratio is the reduction of the aggregate net income due to increased losses for this quarter.

Reserve leverage decreased by 3.5% q/q and financial leverage decreased by 1.9% q/q. Total equity increased by 6.0% q/q while reserves increased by 2.3%, thus decreasing reserve leverage. The slower increase of assets compared to equity decreased financial leverage. Net Written Premiums to Equity, which is a very rough inverse measure of solvency, increased by 6.8% q/q reaching 58.7%.

The investment portfolios of Bermuda (re)insurance groups produced a low RoI of 0.6%, an improvement of 3.9% q/q. RoE dropped significantly by 32.0% q/q due to higher losses. As a proxy for liquidity, the sum of cash and high quality "AAA"-rated securities represents 194.1% of claims for Q2-2016, a decrease of 19.8% q/q.

[1] *The information presented in this section relates to public filings under US GAAP of publicly traded insurance groups that have an entity registered as a Class 4 or 3B commercial (re-)insurer and fall within the group wide supervision by the Authority ("Bermuda groups"). The presented information is based on aggregated individual firm data.*

[2] *Note that the quarter-on-quarter (q/q) change compares the change in a value between the current quarter and the corresponding quarter of the previous year, e.g., Q2-2016 and Q2-2015.*

Table 1. Select Financial Soundness Indicators (FSIs)*

(In % unless indicated otherwise)	2016 Q2	2016 Q1	2015 Q4	2015 Q3	2015 Q2	2015 FY	2014 FY	Change (%) QoQ	Change (%) YoY
Capital Adequacy and Asset Quality									
Assets (In US$ bln)	**204.2**	200.7	192.5	197.8	196.2	**192.5**	169.8	4.0	13.4
Reserves to Assets (Reserve Ratio)	**56.7**	56.8	56.2	56.8	57.7	**56.2**	56.8	-1.6	-1.1
Reserves to Equity (Reserve Leverage) 1/	**189.5**	189.2	182.7	192.1	196.3	**182.7**	177.4	-3.5	3.0
Assets to Equity (Financial Leverage) 2/	**334.0**	332.8	325.1	338.5	340.4	**325.1**	312.1	-1.9	4.2
Net Written Premiums to Equity 3/	**58.7**	57.9	56.1	55.7	54.9	**56.1**	57.8	6.8	-2.9
Profitability and Actuarial Issues									
Gross Profit (excl. capital gains) (In US$ bln)	**1.0**	1.5	1.7	1.5	1.5	**6.5**	7.0	-31.1	-7.2
Investment Income to Net Income	**82.7**	77.6	65.8	205.1	56.6	**68.5**	54.7	46.1	25.3
Combined Ratio	**97.2**	89.5	88.4	90.2	90.9	**89.1**	86.5	6.9	3.0
Average Claims to Reserves 4/	**2.2**	2.1	2.3	2.0	1.9	**1.8**	2.0	17.2	-10.8
Return on Equity	**1.5**	1.4	1.7	0.6	2.3	**7.0**	9.7	-32.0	-27.4
Return on Investment	**0.6**	0.5	0.5	0.5	0.6	**2.3**	2.5	3.9	-7.8
Cash and "AAA" Assets to Claims 5/	**194.1**	210.9	228.3	236.7	242.1	**221.3**	315.3	-19.8	-29.8

Source: Authority staff calculations.

Note: numbers may not add up due to rounding.

1/ Reserve leverage is the ratio between reserves and shareholder's equity (defined as share capital plus additional paid-in capital and retained earnings).

2/ Financial leverage is based on total assets divided by total common equity.

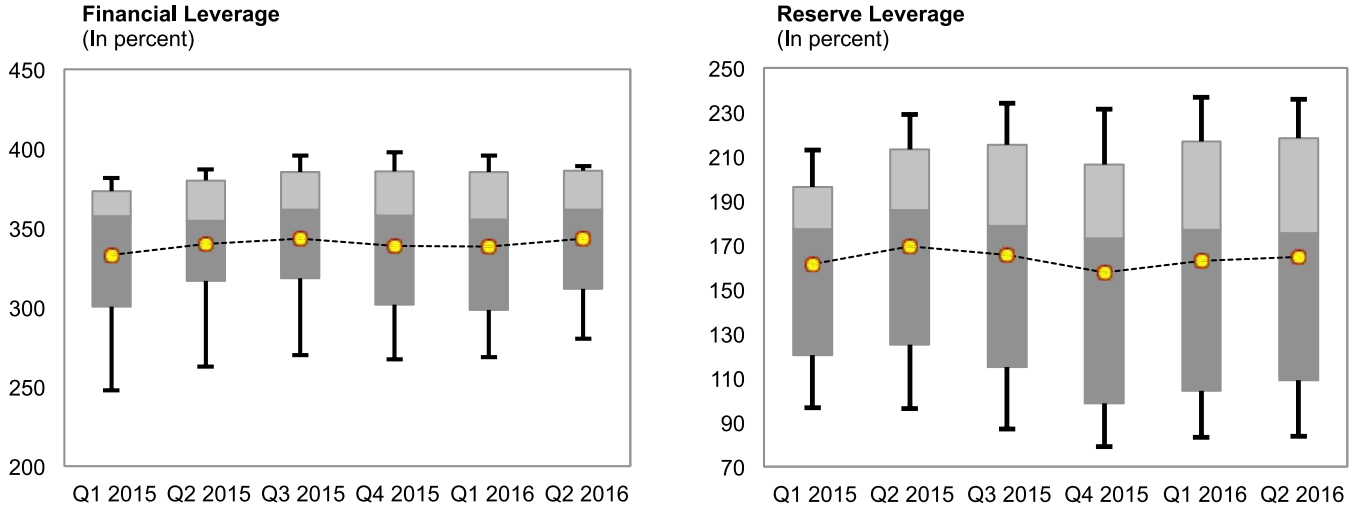
3/ The quarterly values contain the cumulative amount of Net Written Premiums over the last four quarters as numerator.

4/ Three-quarter average.

5/ Due to frequent revisions of the components of the ratio from Bloomberg, the series is stated only for firms without restatements. The general picture with the past does not change from a qualitative point of view.

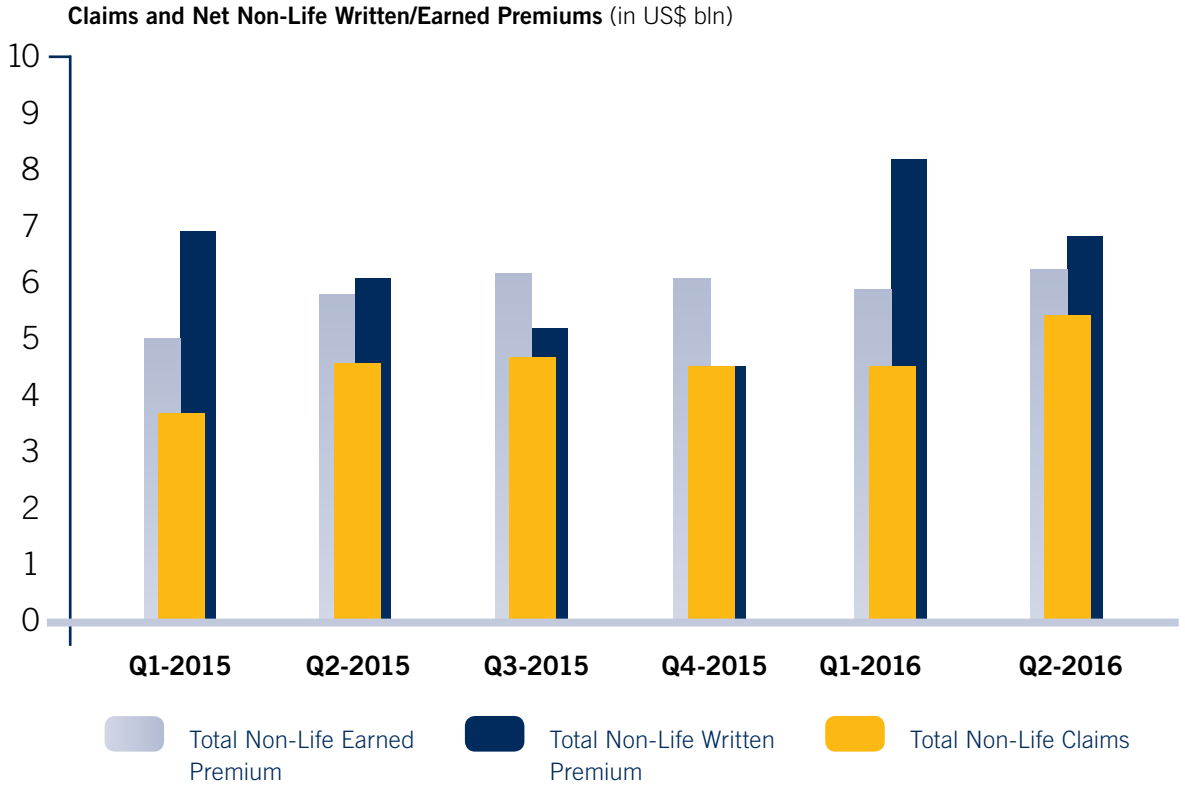
** Due to mergers the current table is not directly comparable to the previous Regulatory Update tables.*

Figure 1. Dispersion of Financial and Reserve Leverage



Source: the Authority staff calculations. Note: Boxplots include the mean (yellow dot), the 25th and 75th percentiles (grey box, with the change of shade indicating the median), and the 10th and 90th percentiles (whiskers).

Figure 2. Claims Volume and Premium Income (Q1-2015 to Q2-2016)



Source: Authority staff calculations.

Regulatory and Legislative

SUPERVISION

Regime Created for Bermuda's Insurance Managers

As part of the ongoing development of Bermuda's insurance regulatory framework, the Authority published a Consultation Paper regarding its oversight of insurance managers in April. Key components of the proposed regime included:

- Requiring Insurance Managers to file an Insurance Manager's Return
- Introducing an Insurance Manager Code of Conduct
- Notifying the Authority for changes of controllers or officers
- Investigating the affairs of insurance managers and
- Extending the AML/ATF regime to include all insurance managers.

The consultation period ended on 27th May 2016 and the Authority proposed to be laid in Parliament an Insurance Amendment Act 2016 which incorporated these changes into the Insurance Act 1978. Subsequently, the Authority published the Insurance Manager Code of Conduct for consultation. The Code established duties, requirements and standards for Insurance Managers. The Code does not have to be implemented until 31st December 2016.

New Electronic Statutory Financial Return (E-SFR) System Available for Captives

On 29th April 2016, the Authority notified limited purpose insurers, i.e. Classes 1, 2, 3, A, B and Special Purpose Insurers (SPIs) that the new E-SFR system was available to file their Statutory Financial Returns (SFR). Such insurers with financial year-endings up to 30th December 2016 were given the option to either submit their SFR via the newly released E-SFR system, or via the existing manual requirements. Limited purpose insurers with financial years ending 31st December 2016 and beyond will only be able to file their SFR electronically via the E-SFR system (a hard copy submission will no longer be required.)

Anti-Money Laundering /Anti-Terrorism Financing (AML/ATF) Schedule Posted for Consultation

In May, the Authority posted a draft schedule for consultation relating to AML/ATF reporting requirements for direct Long-Term (life) insurers. The Authority proposed that this schedule be filed as part of their annual prudential returns to provide the Authority with their AML/ATF risk profiles.

Actuary and Auditor Guidance Notes Issued

The Authority responded to industry comments on the Actuary's Opinion on Economic Balance Sheet (EBS) Technical Provisions in May. Key changes made during the consultation process included:

- Removing the American Academy of Actuaries (AAA) from the list of actuarial bodies and replacing the term "official actuarial body" with "credentialing actuarial body"
- Moving the original paragraph 31, which discusses the Authority's approach to approving one or more actuaries (particularly in a group context), to paragraph 24
- Clarifying in "Part 6 – Relevant Comment" of the opinion, that material adverse deviation applies to General Business only

These changes were included in a Guidance Note – Actuary's Opinion on EBS Technical Provisions – which sets out the Authority's expectations for the professional opinions required for the technical provision elements of EBS. The EBS Actuary's Opinion requirement applies to all commercial (re)insurers and insurance groups.

In June, the Authority published two Guidance Notes regarding the Role of the Approved Auditor. The first Guidance Note provided guidance for limited purpose insurers, i.e. Class 1, 2, 3, A, B and Special Purpose Insurers (SPIs), and the second related to commercial (re)insurers and groups. The Guidance Notes also provided directions on the approval process and criteria upon which the Authority will assess applications.

Housekeeping Amendments Made to Insurance Rules

The Authority published proposed housekeeping amendments to specific schedules within the Insurance (Prudential Standards) Rules for commercial insurers and insurance groups in May. Also in May, the Authority proposed amendments to the Eligible Capital Rules and Insurance (Group Supervision) Rules to provide clarity about Tier 1 ancillary capital requirements. The consultation period for both amendments ended on 23rd June 2016.

Determination of Appeals Rights Corrected

In May, the Authority sought to correct unintended anomalies relating to appeal provisions within various Regulatory Acts. Under the current "Determination of Appeals" sections of the Acts, several of the rights of appeal that arise under the relevant "Rights of Appeals" sections were inadvertently omitted. Therefore, the Authority proposed that the "Determination of Appeals" provisions of the Acts will now apply to all rights of appeals. Parliament approved the Bill which will come into effect on 1st January 2017. In light of these amendments, the Authority is reviewing the respective Appeal Tribunal Regulations.

INTERNATIONAL

In April, the Authority attended the Asociación de Supervisores de Seguros de Latinoamérica (ASSAL) Annual Conference in Rio de

Janeiro to participate on a reinsurance roundtable. Other conference agenda items included: trends in regulation, capital models in Latin America and the United Nations' principles for sustainable insurance. And in May, the Authority participated in a roundtable on captive insurance regulation at the Alternative Conference Institute's Captive Forum in New York City. In addition, the Authority attended the Financial Stability Institute's (FSI) Regional Seminar for Insurance Supervisors in Panama City. Continued participation in FSI seminars offers the opportunity to train other regulators.

Other regulatory meetings attended by the Authority in May include a Financial Stability Board (FSB) Regional Consultative Group for the Americas meeting in Montreal, Canada, a meeting of the International Organisation of Securities Commissions (IOSCO) in Lima, Peru and the annual meeting of the Caribbean Group of Banking Supervisors in Kingston, Jamaica. International Association of Insurance Supervisors (IAIS) Meetings attended during Q2-2016 included the Capital Solvency and Field Testing Group in Ottawa, Canada in May, and the Macroprudential Working Group in Lichtenstein in June. Strong relations with supervisory counterparts in the US were maintained by attending meetings of the National Association of Insurance Commissioners (NAIC) in May – in particular an NAIC International Insurance Forum in Washington DC and a meeting with the NAIC's Securities Valuation Office (SVO) to discuss securities ratings being used by non-US entities/agencies. In addition, the Authority attended the Group of International Insurance Supervisors' annual meeting in London in June to discuss issues pertaining to Bermuda's insurers. Also in June, a plenary of the Financial Action Task Force (FATF) was attended in South Korea to continue important discussions relating to Bermuda's upcoming Anti-Money Laundering/Anti-Terrorist Financing (AML/ATF) assessment.

OTHER

In May, the Authority hosted the second meeting of the Financial Policy Council (Council). The Council, established in 2015, advises the Ministry of Finance and the Authority on financial system stability in Bermuda. Its purpose is to assess possible threats to Bermuda's financial stability, and to identify policies and actions to mitigate or eliminate such threats. It also advises on development of the financial stability framework in Bermuda, and makes policy recommendations designed to support the general economic and financial well-being of the country. Members of the Council are the Deputy Premier and Minister of Finance the Hon. E.T. Richards JP MP (chair), Sir Andrew Large (deputy chair), Authority CEO Jeremy Cox, Sir Courtney Blackman and Michael Butt. On 23rd June, the UK voted to leave the European Union. Formal exit negotiations have not taken place but the Council continues to consider the potential impacts of 'Brexit' on Bermuda's financial sector, particularly Bermuda's banking and international (re)insurance sectors.

On the jurisdictional business development front, the Authority once again supported the Bermuda Captive Conference in June. This annual event – which grows in popularity each year – featured Joe Flower, a leading international expert in healthcare, genomics and biotech, as the key note speaker. Topical and emerging captive issues were addressed including cyber, oil and gas risk, emerging markets like Canada and Latin America, as well as ILS/collateralised reinsurance. Members of the Authority participated on three panel sessions: 'Introduction to Captives'; 'Bermuda Regulatory Session – Electronic Filing'; 'Technical briefs' and an opening round table, moderated by the Head of the Bermuda Insurance Managers Association. In addition, the Authority attended an executive forum and related meetings at a Bermuda Business Development Agency (BDA) event in Toronto, Canada in May.

Explanatory Notes:

- Class 1: Single-parent captive insuring the risks of its owners or affiliates of the owners.
- Class 2: (a) a multi-owner captive insuring the risks of its owners or affiliates of the owners; or (b) a single parent or multi-owner captive: (i) insuring the risks arising out of the business or operations of the owners or affiliates, and/or (ii) deriving up to 20.0% of its net premiums from unrelated risks.
- Class 3: Captive insurers underwriting more than 20.0% and less than 50.0% unrelated business.
- Class 3A: Small commercial insurers whose percentage of unrelated business represents 50.0% or more of net premiums written, or loss and loss expense provisions and where the unrelated business net premiums are less than $50.0 million.
- Class 3B: Large commercial insurers whose percentage of unrelated business represents 50.0% or more of net premiums written, or loss and loss expense provisions and where the unrelated business net premiums are more than $50.0 million.
- Class 4: Insurers and reinsurers capitalised at a minimum of $100.0 million underwriting direct excess liability and/or property catastrophe reinsurance risk.
- Long-Term – Class A:
  A single-parent Long-Term (life) captive insurance company underwriting only the Long-Term business risks of the owners of the insurance company and affiliates of the owners.
- Long-Term – Class B:
  Multi-owner Long-Term captives which are defined as Long-Term insurance companies owned by unrelated entities, provided that the captive underwrites only the Long-Term business risks of the owners, and affiliates of the owners and/or risks related to or arising out of the business or operations of their owners and affiliates. A Class B license will also apply to single-parent and multi-owner long-term captives writing no more than 20.0% of net premiums from risks which are not related to, or arising out of, the business or operations of their owners and affiliates.
- Long-Term – Class C:
  Long-Term insurers and reinsurers with total assets of less than $250.0 million, and not registrable as a Class A or Class B insurer.
- Long-Term – Class D:
  Long-Term insurers and reinsurers with total assets of $250.0 million or more but less than $500.0 million, and not registrable as a Class A or Class B insurer.
- Long-Term – Class E:
  Long-Term insurers and reinsurers with total assets of more than $500.0 million, and not registrable as a Class A or Class B insurer.
- SPI: A Special Purpose Insurer (SPI) assumes insurance or (re)insurance risks and typically fully funds its exposure to such risks through a debt issuance or some other financing.
- Intermediaries: Insurance managers, insurance brokers, insurance agents and insurance salesmen, as defined in Section 10 of the Insurance Act 1978.

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