QUARTERLY

Banking Digest

Q4-2015

BMA
BERMUDA MONETARY AUTHORITY

NEW BASEL III REQUIREMENTS

- Basel III adoption is in effect beginning 1st January 2015 with a phase-in period for capital requirements commencing from 2016 to 2019 (when full implementation will take place). The sector's capital adequacy will be reported on a parallel basis under both Basel II & III until Q4-2015. Basel III capital adequacy and liquidity reporting will be permanent as of 1st January 2016 after which Basel II reporting will be discontinued.
- Basel III risk-based capital requirements are reported, including new capital ratios and a fully implemented leverage ratio.
- Basel III - Liquidity Coverage Ratio (LCR) reporting became effective 1st January 2015 for all banks.

PERFORMANCE HIGHLIGHTS

- **Capital adequacy levels improved in Q4, as the banking sector remains comfortably above the minimum regulatory capital requirements.** Risk Asset Ratio (RAR) under Basel II increased from 20.8% to 21.3% and the Basel III RAR increased from 17.3% to 17.7%. The primary capital adequacy measure of Tier 1 to Risk-Weighted Assets (RWAs) rose from 19.2% to 19.7%, while the Common Equity Tier 1 (CET1) was slightly better than the previous quarter, rising from 15.6% to 15.9%.
- **Boost in earning assets helped increase balance sheet growth in Q4.** Total assets reported by banks increased by 2.8% to $24.1 billion during the quarter and 4.3% year-on-year. The majority of the growth was due to the rise in investments (up 13.5%) and lending activity (up 6.4%); while the decline in interbank deposits (down 22.5%) offset most of the increase in total assets.
- **Banks continued to prudently manage their banking book, as asset quality indicators show steady improvement.** Local banks' non-performing loans (NPLs) as a percentage of their total loans continued on a downtrend over 2015. Their NPL ratio fell to 8.0% at the end of 2015, compared with 10.4% at the end of 2014. Provisions to NPLs also rose, reaching 23.7% during the quarter compared to 20.7% in the previous quarter and 19.1% in the same period last year. However, the increase in this ratio is mainly due to slightly higher provision levels (up 5.3%) compared to lower reported NPLs (down 9.4%).
- **Q4 profits were negatively impacted by lower earnings and higher operating and non-operating costs.** Overall net income levels fell during the quarter, with earnings from banking income and non-banking income decreasing by 5.8% and 21.6%, respectively. Costs associated with bank operations and non-operating expense rose by 13.9%.

SUMMARY INDICATORS

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

Table I: Selected Indicators

	2015				2014
(Ratios in %)	Dec	Sep	Jun	Mar	Dec
Capital Position					
Risk Asset Ratio (RAR)	21.3	20.8	20.8	21.8	22.8
Basel III – RAR (8.0%)**	17.7	17.3	17.1*	n/a	
Tier 1 to Risk-Weighted Assets (RWAs)	19.7	19.2	19.3	20.2	21.1
Basel III – CET I Ratio (4.5%)**	15.9	15.6	15.6*	n/a	
Assets to regulatory capital (multiple)	11.9	11.6	12.0	11.2	10.7
Regulatory leverage ratio (equity to total assets)	8.4	8.8	8.4	9.2	9.5
Basel III – Leverage Ratio	7.4	7.7	7.4*	n/a	
Liquidity					
Cash/cash equivalents to total deposits liabilities	18.2	24.2	27.1	25.3	26.3
Loan-to-deposit ratio	42.5	41.2	39.3	39.7	40.8
Funding gap***	-51.1	-51.9	-54.4	-53.5	-52.2
Profitability					
Interest margin to interest income	91.5	92.2	91.5	91.5	91.5
Return on assets	0.4	1.0	0.8	1.0	0.7
Return on equity	4.0	11.2	8.4	9.8	7.1
Loan Book					
Provisions to Non-Performing Loans (NPLs)	23.7	20.7	19.7	18.8	19.1
NPLs to total loans	8.0	9.4	9.5	10.1	10.4
NPLs to capital	35.7	39.6	40.3	39.8	40.1
Other					
Change in BD$ money supply	0.8	-2.4	0.4	2.1	-0.9
Change in assets	2.8	-4.9	2.2	4.4	4.4
Change in RWAs	-2.0	-1.5	-0.9	5.1	0.1
Change in customer deposits	3.4	-6.3	3.2	5.1	8.0

** Restated*

*** Basel III requirements as per the Final Rules, subject to the phase-in period with full implementation commencing in 2019.*

**** Loans, less deposit liabilities; divided by total assets.*

BALANCE SHEET

Aggregate Balance Sheet

Table II below provides a summary of key balance sheet trends in the sector.

Table II: Aggregate Balance Sheet

(BD$ blns)	2015				2014	Change (In %)	
	Dec	Sep	Jun	Mar	Dec	QoQ	YoY
Assets							
Cash	0.1	0.1	0.1	0.1	0.1	*-1.2*	*6.4*
Deposits	3.8	4.9	5.9	5.3	5.3	*-22.5*	*-27.8*
Loans & advances	9.1	8.5	8.7	8.5	8.3	*6.5*	*9.4*
Investments	10.4	9.2	9.3	9.4	8.6	*13.5*	*20.6*
Other assets	0.7	0.7	0.7	0.8	0.8	*-4.2*	*-13.8*
Total assets	**24.1**	**23.4**	**24.6**	**24.1**	**23.1**	***2.8***	***4.3***
Liabilities							
Savings deposits	6.5	6.0	6.2	6.4	6.0	*7.6*	*7.5*
Demand deposits	11.7	11.1	12.2	11.4	10.5	*5.1*	*10.7*
Time deposits	3.2	3.5	3.7	3.6	3.8	*-9.1*	*-15.0*
Total deposits	**21.4**	**20.7**	**22.1**	**21.4**	**20.3**	***3.4***	***5.0***
Other liabilities	0.6	0.6	0.4	0.4	0.4	*-3.1*	*31.7*
Total liabilities	**21.9**	**21.2**	**22.5**	**21.8**	**20.8**	***3.2***	***5.6***
Equity and subordinated debt	2.1	2.2	2.2	2.3	2.3	*-1.3*	*-6.9*
Total liabilities and equity	**24.1**	**23.4**	**24.6**	**24.1**	**23.1**	***2.8***	***4.3***

Totals may not add due to rounding.

- Overall sector assets rose by 2.8% (or $657.0 million) in Q4-2015 and are higher than levels reported a year ago (up 4.3% or $995.0 million). The quarterly increase was largely driven by investment growth (up 13.5% or $1.2 billion) followed by loans and advances (up 6.5% or $554.5 million). The growth in earning assets was aided by the combination of higher deposit liability inflows (up $703.0 million) and the reallocation of funds from interbank deposits (down $1.1 billion).

- Deposit liabilities rose by 3.4% (or $703.0 million) during the quarter and higher year on year (YoY) by 5.0% (or $1.0 billion). The quarterly increase was led primarily by demand deposits (up 5.1% or $567.0 million) and savings deposits (up 7.6% or $458.0 million). While time deposits fell by 9.1% (or $322.0 million) negating some of the overall growth in deposit liabilities. The quarterly increase in demand and saving deposit liabilities was mainly attributed to the net inflow of foreign currency deposits, which grew by 3.9% during the quarter.

Summary of Balance Sheet Ratios

Table III provides a summary of balance sheet ratios measuring asset quality and capital.

Table III: Summary of Balance Sheet Ratio

(In % unless indicated otherwise)	2015				2014
	Dec	Sep	Jun	Mar	Dec
Asset allocation					
Investments	43.3	39.2	37.7	39.1	37.4
Loans	37.7	36.4	35.2	35.3	35.9
Deposits	15.8	21.0	23.9	22.1	22.9
Deposits allocation					
Savings	30.4	29.2	28.1	29.9	29.7
Demand	54.6	53.7	55.1	53.3	51.8
Time	15.0	17.1	16.8	16.8	18.5
Capital position					
Risk Asset Ratio (RAR)	21.3	20.8	20.8	21.8	22.8
Basel III – Risk Asset Ratio**	17.7	17.3	17.1*	n/a	
Equity to total assets	8.4	8.8	8.4	9.2	9.5
Basel III – Leverage Ratio	7.4	7.7	7.4*	n/a	
Assets to regulatory capital (multiple)	11.9	11.6	12.0	11.2	10.7
Loan book					
NPLs to total loans	8.0	9.4	9.5	10.1	10.4
Provisions to NPLs	23.5	20.7	19.7	18.8	19.1
Provisions to total loans	2.2	2.3	2.1	2.1	2.2

Totals may not add due to rounding.
**** Restated***
***** Basel III requirements as per the Final Rules, subject to the phase-in period with full implementation commencing in 2019.***

- The sector's capital position improved in Q4-2015, as the regulatory RAR rose from 20.8% to 21.3%. Net capital remained steady relative to risk-weighted asset, which fell by 2.0% during the period. This is the third consecutive quarter that banks have reduced their risk exposure. The regulatory capital measure of Tier 1 capital to RWAs increased from 19.2% to 19.7%.

- The capital position under the new Basel III requirements continued to be well above the minimum regulatory standard, as both the Basel III - RAR and the Common Equity Tier 1 (CET 1) increased to 17.7% and 15.9%, respectively.

- Non-performing loans (NPLs) held by banks declined further in Q4-2015. NPLS made up 8.0% of total loans for the quarter, improving from 9.4% seen in Q3-2015 and are better than the 10.4% observed a year ago. NPLS decreased by 9.4% (or $75.3 million) compared to the increase in total loans (up 6.5% or $553.5 million). The NPL ratio is one of the key indicators used to evaluate the quality of assets held by the banking sector.

- The coverage ratio of provisions to NPLs continued to rise, increasing from 20.7% to 23.5% for the quarter. Provisional levels were up by 5.3% (or $10.2 million) relative to the decline in NPLs (down 9.4% or $75.3 million). Banks remain committed to keeping sound provisioning levels to cover potential loan losses within their banking book.

Capital Adequacy

Chart I below shows the movement in the Risk Asset Ratio (RAR) and the leverage ratio over the last two years.

Chart I: Risk Asset Ratio and Leverage Ratio

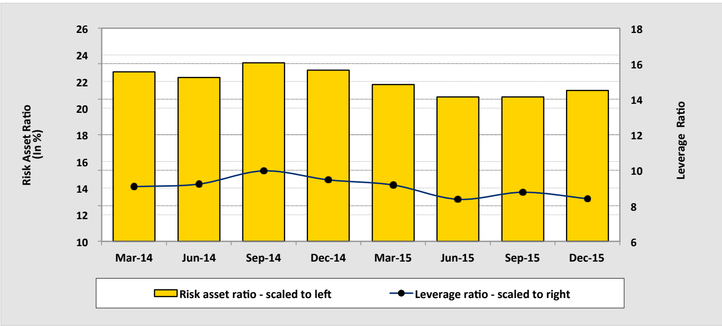


Chart II below reflects the movement in total assets and the change in Risk-Weighted Assets (RWAs) over the last two years.

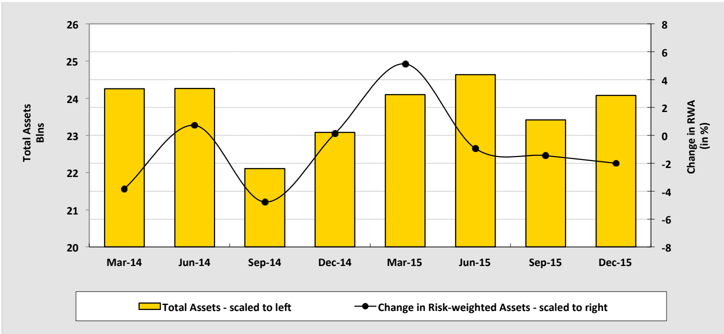


Chart II: Total Assets and Change in RWAs

- These capital adequacy measures showed a modest improvement for the quarter; helped by lower risk exposures and stable capital levels. The regulatory capital adequacy ratios still exceeds international standards, with RAR increasing to 21.3% and Tier 1 to Risk-Weighted Assets (RWAs) increasing to 19.7%.

- The leverage for the banking sector was fairly stable as both the Basel III and regulatory leverage ratios experienced marginal declines, falling to 7.4% and 8.4%, respectively.

Asset Quality

Loan Book

Table IV is a summary of ratios measuring the composition and quality of the loan book for the last five quarters.

	2015				2014
(In %)	Dec	Sep	Jun	Mar	Dec
Loans and advances quarter-over-quarter growth rate	6.5	-1.7	2.0	2.5	5.8
Residential mortgages to total loans	46.0	49.0	48.7	48.8	51.0
Loan impairments					
NPLs to total loans	8.0	9.4	9.5	10.1	10.4
NPLs to capital	35.7	39.6	40.3	39.8	40.1
Net charge-offs to loans (annualised)	1.0	0.6	0.5	0.3	0.8
Loan provisioning					
Provisions to NPLs	23.5	20.7	19.7	18.8	19.1
Provisions to total loans	2.2	2.3	2.1	2.1	2.3

Table IV: Quality of the Loan Book

- The quality of the loan book continued to show some improvement as NPLs to total loans and NPLs to capital have steadily declined over the past year. Quarterly provision levels continued to increase as banks set aside $202.1 million to cover potential credit losses. Net charge-offs as a percentage of total loans rose from 0.6% to 1.0%, reaching its highest level for 2015.

Sectoral Distribution of Loans

Charts III and IV reflect the sectoral distribution of loans during the quarter and the variation of lending to the different sectors over the last five quarters.

Chart III: Sectoral Distribution of Loans and Advances

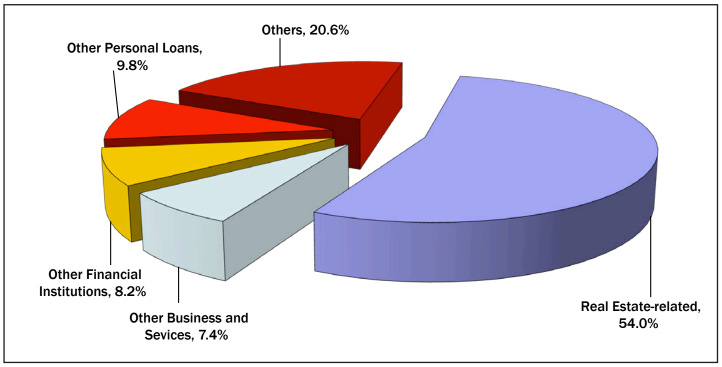
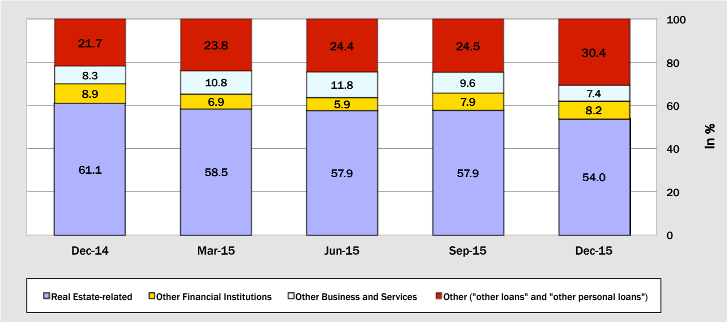


Chart IV: Sectoral Distribution of Loans and Advances

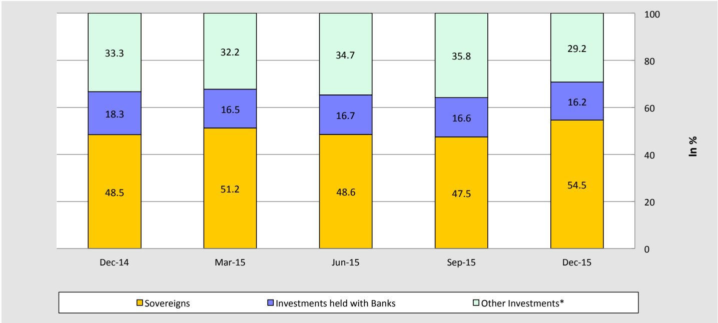


- Quarterly loan activity within the real-estate market stayed muted, with loans to this sector falling to its lowest level since the first quarter of 2009. Residential mortgages as a percentage of total loans also declined, falling from 49.0% to 46.0%. Loans to "Other" sectors picked up, increasing from 24.5% to 30.4% during the period, while loans to "Other Business and Services" fell for the second successive quarter from 9.6% to 7.4%.

Investment Book

Chart V below shows the structure of the aggregate investment book during the quarter.

Chart V: Sectoral Structure of the Investment Book*



**** Includes: public sector entities (PSEs), securitised (non-equity tranches) investments, securitised (equity tranche) investments, investments in the capital of other banks, and investments in subsidiaries and associated companies.***

- The investment book returned to a more conservative position, with banks holding more highly-liquid, low-risk securities. Sovereign investments, which largely consist of highly-rated securities, rose sharply from 47.5% to 54.5% of total investments. Conversely, "Other Investments" fell during the quarter to 29.2% after three periods of steady growth. The decline is primarily attributed to the decline in securitised (non-equity) investments (down 8.7%).

Liquidity and Liquidity Coverage Ratio (LCR)

Table V shows the liquidity condition of the banking sector over the last five quarters.

Table V: Liquidity Indicators

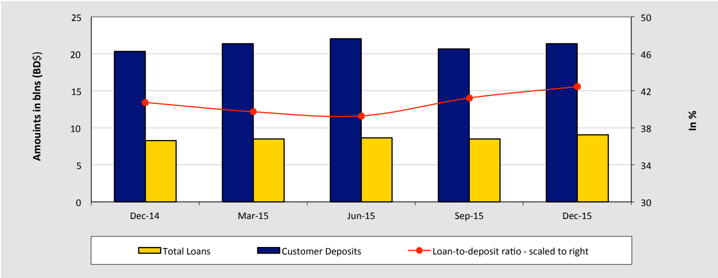
	2015				2014
(In %)	Dec	Sep	Jun	Mar	Dec
Cash and deposits to total assets	16.2	21.4	24.2	22.4	23.2
Cash and cash equivalents to total deposit liabilities	18.2	24.2	27.1	25.3	26.3
Loan-to-deposit ratio	42.5	41.2	39.3	39.7	40.7
Loans-to-total assets	37.7	36.4	35.2	35.3	35.9
Funding gap*	-51.1	-51.9	-54.4	-53.5	-52.2

**** The difference between total loans and total deposits divided by total assets.***

- All regulated financial institutions continued to meet the regulatory minimum liquidity requirements.
- The sector's liquidity funding structure remained positive, with the ratio of loans to total deposits rising for the third successive quarter from 41.2% to 42.5% during the quarter. Higher quarterly loan activity (6.5%) compared to an increase in customer deposits (up 3.4%) resulted in a further narrowing in the sector's funding gap.
- As of the end-December 2015, all banks complied with the phased-in 60% LCR requirement.

Chart VI below shows the change in total loans, customer deposits, and the consolidated loan-to-deposit ratio (for both BD$ and FX) over the last five quarters.

Chart VI: Total Loans and Deposits



PROFIT AND LOSS

Table VI below is a summary of profitability ratios for the sector for the last five quarters.

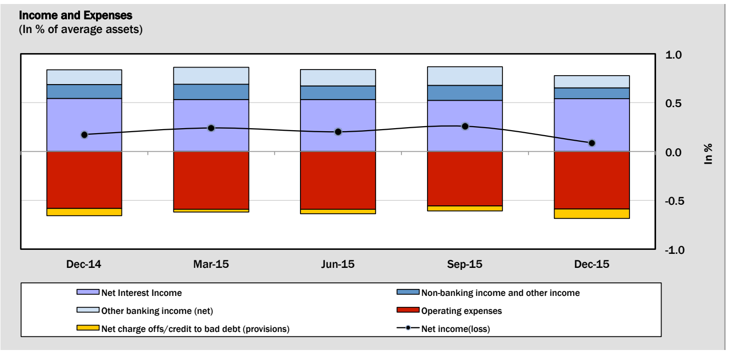
Table VI: Summary of Profitability Ratios

(In %)	2015				2014
	Dec	Sep	Jun	Mar	Dec
Net interest margin to total income	69.9	60.4	63.4	61.8	64.8
Annualised net interest margin to (average) earning assets*	2.2	2.1	2.1	2.1	2.2
Annualised interest income to (average) earning assets*	2.4	2.3	2.3	2.3	2.4
Banking income to total income	86.0	82.5	83.4	81.8	82.8
Non-interest income to total income	14.0	17.5	16.6	18.2	17.2
Non-interest expenses to total income	88.5	70.2	76.0	72.1	79.1
Personnel expenses to non-interest expenses	45.1	49.7	48.5	50.3	47.4
Return on Assets (RoA)*	0.4	1.0	0.8	1.0	0.7
Return on Equity (RoE)**	4.0	11.2	8.4	9.8	7.1

** Earning assets are averaged over the last four quarters.*
*** Shareholders' equity is averaged over the last four quarters.*

Chart VII below shows the change in income and expense elements of the aggregate profit and loss statement of the sector over the last five quarters.

Chart VII – Income and Expenses



Margin Analysis

- Sector profits declined during the quarter, despite better reported margins. The net interest margin showed a noticeable increase during the quarter, rising from 60.4% to 69.9% of total income. However, the combination of lower quarterly non-banking income (down 21.6%) and increased operating and non-operating expenses (up 13.9%) eroded Q4 profits. Profits are also 50.0% lower than amounts reported by banks a year ago.

- The banking sector's cost efficiency deteriorated during the quarter, as non-interest expenses as a percentage of total income jumped from 70.2% to 88.5%. Operating and non-operating expenses increased by 13.9% compared to the negative change in total income (down 9.6%).

Chart VIII reflects the distribution of income sources as of end-December 2015.

Chart VIII: Distribution of Income Sources

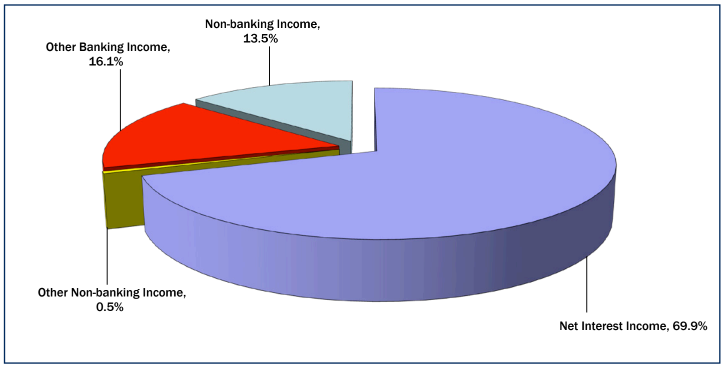
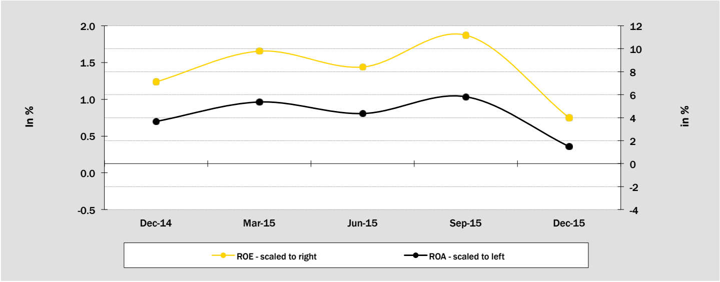


Chart IX shows the trend in RoE and RoA over the last five quarters.

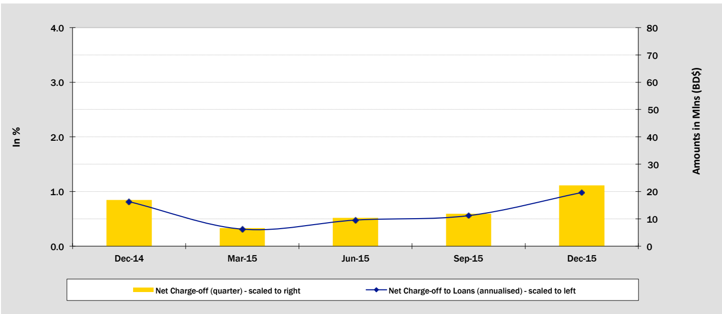
Chart IX: Annualised Return on Assets and Return on Equity



- The noticeable decline in bank profits resulted in lower quarterly returns as both the annualised RoE and RoA decreased from 11.2% to 4.0% and from 1.0% to 0.4%, respectively.

Chart X shows the actual net charge-offs and the annualised change relative to total loans over the last five quarters.

Chart X: Net Charge-off Amount and Proportion of Annualised Charge-offs to Loans



Charge-offs for Loan Losses and Loan Impairments

- Net charge-offs amounting to $22.3 million in Q4-2015, are $10.4 million (or 87.1%) higher than amounts reported in the previous quarter and $5.4 million (or 32.0%) higher compared to amounts a year earlier.

Foreign Currency (FX) Balance Sheet

Table VII below shows the aggregate FX balance sheet of the sector over the last five quarters.

Table VII: Foreign Currency Balance Sheet

	2015				2014	Change (In %)	
(In BD$ blns)	Dec	Sep	Jun	Mar	Dec	*QoQ*	*YoY*
Loans and advances	5.2	4.6	4.6	4.4	4.2	*13.3*	*25.7*
Total assets	19.7	19.0	20.1	19.5	18.4	*3.7*	*7.5*
Deposit liabilities	18.0	17.4	18.7	18.1	17.1	*3.9*	*5.2*

- The FX$-denominated total assets increased by 3.7% during the quarter, which also 7.5% higher than amounts reported year-on-year. Quarterly FX$-denominated deposit liabilities rose by 4.0%, driven primarily by the inflow of FX$-denominated saving deposits (up 10.0%) and FX$-denominated demand deposits (up 5.4%). However, the decline in FX$-denominated time deposits (down 11.7%) negated some of the foreign currency deposit liability growth.

Table VIII below shows the foreign currency position for the sector for the last five quarters.

Table VIII: Foreign Currency Positions

	2015				2014
(In %)	Dec	Sep	Jun	Mar	Dec
FX-denominated assets to total assets	81.9	81.2	81.6	80.8	79.5
FX-denominated loans to total loans	57.4	54.0	53.6	52.0	50.0
FX-denominated deposits to total deposits	84.4	84.0	84.9	84.5	84.3
Changes in FX assets	3.7	-5.4	3.2	6.1	7.5
Changes in FX loans and advances	13.3	-1.0	5.3	6.5	14.7
Changes in FX customer deposits*	3.9	-7.4	3.7	5.3	9.9

** Percentage change based on absolute numbers.*

- The sector's foreign currency position increased during the quarter, with the percentage of FX$-denominated deposits to total deposits rising modestly from 84.0% to 84.4%. FX$-denominated loans as percentage of total loans rose for the fourth consecutive quarter, rising from 54.0% to 57.4%.

Table IX is a summary of ratios measuring the liquidity of the FX$-denominated bank balance sheet for the last five quarters.

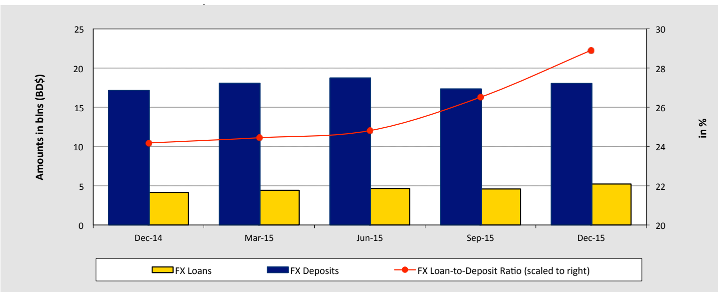
Table IX: Liquidity Indicators (FX Positions)

	2015				2014
(In %)	Dec	Sep	Jun	Mar	Dec
Cash and deposits to total assets	19.4	26.0	29.3	27.3	28.8
Cash and cash equivalents to total deposit liabilities	21.2	28.5	31.4	29.5	30.8
Loan-to-deposit ratio	28.9	26.5	24.8	24.4	24.2
Loans to total assets	26.4	24.2	23.1	22.7	22.6
Funding gap*	-65.0	-67.1	-70.1	-70.1	-70.8

** The difference between total loans and total deposits divided by total assets*

Chart XI shows the movement in FX$-denominated loans and deposits, and the ratio of FX$-denominated loans to customer deposits, for the last five quarters.

Chart XI: FX Loans and Customer Deposit



- The sector's foreign currency liquidity funding ratio continued to trend upward, rising from 26.5% to 28.9%. The sharp increase seen in FX$-denominated lending (up 13.0%) outpaced the rise in FX$-denominated customer deposits (up 4.0%).

Bermuda Dollar Balance Sheet

Table X below shows the aggregate Bermuda Dollar balance sheet of the sector over the last five quarters.

- The overall BD$-denominated balance sheet experienced little change over the prior quarter and remained lower than amounts reported year-on-year.

Table X: Bermuda Dollar Balance Sheet

(In BD$ blns)	2015				2014	Change (In %)	
	Dec	Sep	Jun	Mar	Dec	*QoQ*	*YoY*
Loans and advances	3.9	3.9	4.0	4.1	4.1	*-1.5*	*-6.8*
Total assets	4.4	4.4	4.5	4.6	4.7	*-1.1*	*-7.9*
Deposit liabilities	3.3	3.3	3.3	3.3	3.2	*0.8*	*4.2*

Note: The BD$-denominated balance sheet of the sector aggregates data submitted on legal entity reporting basis, which is different from the presentation of the banking statistics in the Regulatory Update, which shows the consolidated sector balance sheet.

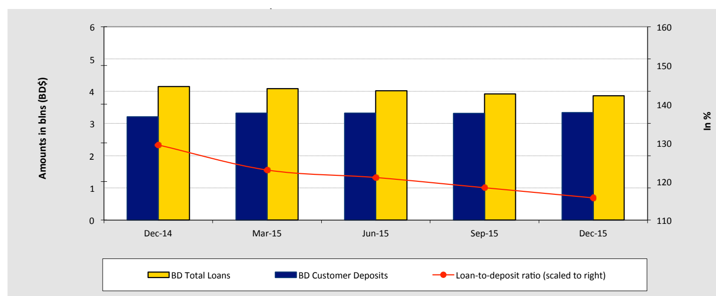
Table XI is a summary of ratios measuring the liquidity of the BD$-denominated balance sheet over the last five quarters.

Table XI: Liquidity Indicators (BD$ Positions)

(In %)	2015				2014
	Dec	Sep	Jun	Mar	Dec
Cash and deposits to total assets	1.6	1.4	1.7	1.8	1.5
Cash and cash equivalents to total deposit liabilities	2.1	1.8	2.3	2.5	2.2
Loan-to-deposit ratio	115.8	118.4	121.0	123.0	129.4
Loans to total assets	88.7	89.0	88.5	88.0	87.7
Funding gap to total BD$ Assets	12.1	13.8	15.4	16.4	19.9

Chart XII shows the movement in BD$-denominated loans and deposits, along with the ratio of BD$-denominated loans to deposits, for the last five quarters.

Chart XII: Bermuda Dollar Loans and Customer Deposits



- The BD$ liquidity as measured by the loan-to-deposit ratio, showed that Bermuda dollar loans are becoming less dependent on foreign currency deposits for supplemental funding. The loan-to-deposit ratio continued to trend downward, falling from 118.4% to 115.8%. Domestic lending experienced negative growth, decreasing by 1.4% (or $56.7 million) compared to the marginal increase in BD$ deposits (up 0.8% or $26.0 million). Consequently, the BD$ liquidity funding gap was further reduced, falling for the fourth consecutive quarter, from 13.8% to 12.1%.

Monetary Aggregates

Table XII shows the trend in the domestic money supply over the last five quarters.

Table XII: Bermuda Money Supply (Unconsolidated)

(In BD$ mln)	2015				2014
	Dec	Sep	Jun	Mar	Dec
Notes and coins in circulation	133	124	122	118	127
Deposit liabilities	3,359	3,333	3,340	3,329	3,259
Banks and deposit companies	**3,492**	**3,457**	**3,462**	**3,447**	**3,386**
less: cash at banks and deposit companies	45	38	36	33	44
Bermuda Dollar money supply	**3,447**	**3,419**	**3,426**	**3,414**	**3,342**
% Growth on previous period	0.8	-0.2	0.4	2.1	-0.9
% Growth y-o-y	3.1	1.3	2.0	-1.9	-2.3

The table includes the supply of Bermuda dollars only.

- BD$ money supply experienced a marginal increase of 0.8% (or $28.7 million) in Q4-2015. The growth in deposit liabilities (up 0.8% or $26.6 million) and notes in coins (up 7.1% or $8.8 million) was partially offset by higher levels of cash held in banks (up 18.4% or $7.0 million).

SELECTED INTERNATIONAL DEVELOPMENTS

This section lists important publications issued during the last quarter by international organisations and national supervisory authorities. This section does not reflect the views of the Bermuda Monetary Authority (the Authority).

Bank for International Settlements (BIS)

In December, the Banking Committee on Banking Supervison (BCBS) published guidance on credit risk and accounting for expected credit losses (ECLs). The guidance sets out supervisory guidance on sound credit risk practices associated with the implementation and ongoing application of ECL accounting frameworks.

http://www.bis.org/bcbs/publ/d350.pdf

The BCBS released its second consultative document on the Standardized Approach (SA) for credit risk. The document forms part of the Committee's broader review of the capital framework to balance simplicity and risk sensitivity, and to promote comparability by reducing variability in risk-weighted assets (RWAs) across banks and jurisdictions.

http://www.bis.org/bcbs/publ/d347.pdf

In November, the BCBS published a working paper which supports applying a macroprudential approach to stress testing as a key complement to the standard bottom-up supervisory approach. The paper stated that stress testing conducted in a microprudential manner could miss key tail risks as it focused on idiosyncratic risk.

https://www.bis.org/bcbs/publ/wp29.pdf

The BCBS published a progress report on the implementation of the Basel III regulatory reforms. The report summarises three areas, which focuses on: monitoring adoption of Basel III standards; assessing consistency and completeness of members' Basel III regulations vis-à-vis the globally agreed Basel standards; and analysing regulatory outcomes.

http://www.bis.org/bcbs/publ/d345.pdf

In October, the BCBS published its frequently asked questions (FAQs) responses on the Basel III monitoring exercise. The responses clarify the definition of capital, the leverage ratio, liquidity, interest rate risk in the banking book (IRRBB) and operational risk.

http://www.bis.org/bcbs/qis/biiiimplmonifaq_sep15.pdf

Bank of England (BoE)

In December, the BoE published the results of the 2015 stress test, which covered seven major UK banks and building societies. The report reveals that stress-test results suggest that the banking system is capitalised to support the real economy in a severe global stress scenario.

http://www.bankofengland.co.uk/financialstability/Documents/fpc/results011215.pdf

European Banking Authority (EBA)

In December, the EBA published a comparative report on the recovery plan scenarios in the European banking sector. The report compares the recovery plans of 19 European cross-border banking groups with parent institutions located across 10 EU countries, with a focus on how institutions have approached and developed their recovery plan scenarios.

http://www.eba.europa.eu/documents/10180/950548/Report+on+benchmarking+scenarios+in+recovery+plans.pdf

In November, the EBA published the draft methodology for the 2016 EU-wide stress test. This document describes the common methodology that defines how banks should calculate the stress impact of the common scenarios and at the same time sets constraints for their bottom-up calculations.

https://www.eba.europa.eu/documents/10180/1259315/DRAFT+2016+EU-wide+ST+methodological+note.pdf

The EBA released its Q3 2015 Risk Dashboard (based on Q2 data). The EBA risk dashboard is based on a sample of Key Risk Indicators (KRI) from 55 banks that summarises the main risks and vulnerabilities in the European banking sector.

http://www.eba.europa.eu/documents/10180/1257370/EBA+Dashboard+-+Q3+2015.pdf

Financial Stability Board (FSB)

In November, the FSB published and finalised its document on principles on loss-absorbing and recapitalisation capacity of G-SIBs in Resolution. The principles outline the new international standards for adequate total loss absorbing capacity for globally significant important banks (G-SIBs).

http://www.fsb.org/wp-content/uploads/TLAC-Principles-and-Term-Sheet-for-publication-final.pdf

The FSB released its guidance paper "Principles for Cross-border Effectiveness of Resolution Actions" that sets out statutory and contractual mechanisms that jurisdictions should consider including in their legal frameworks to give cross-border effect to resolution actions in accordance with the Key Attributes.

http://www.fsb.org/wp-content/uploads/Principles-for-Cross-border-Effectiveness-of-Resolution-Actions.pdf

Financial Policy Committee (FPC)

In December, the FPC published a report on the evolution of the framework for bank capital requirements and its final calibration post-2019. The report provides the views of the FPC on the overall calibration of the capital framework for both the going and gone concern elements for the UK banking system.

http://www.bankofengland.co.uk/publications/Documents/fsr/2015/fsrsupp.pdf

Prudential Regulation Authority (PRA)

In November, the PRA released its H2 2015 stress scenario. These supervisory scenarios are designed to complement firms' own calibration of scenarios for Pillar 2 capital planning stress tests.

http://www.bankofengland.co.uk/pra/Pages/supervision/activities/anchorscenario2015.aspx

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.

Additional Tier 1 Capital (AT1) is represented by allowable components of Tier One Capital other than Common Equity.

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

Common Equity Tier 1 Capital (CET 1) is the primary and predominant form of regulatory capital, and will be used as the primary capital adequacy measure for all Bermuda banks once Basel III becomes fully implemented.

CET 1 Ratio measures the bank's primary core equity capital compared with its total Risk-Weighted Assets. The measurement is used to determine the financial strength of a bank.

Coverage Ratio (Provisions to NPLs) is the ratio that shows the extent to which non-performing loans are already covered by provisions.

Earning assets includes deposits with other financial institutions, loans, advances and leases, and investments.

Equity refers to the shareholder 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.

Funding gap is defined by the difference between total loans and total deposits divided by total assets.

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 shareholder equity divided by total assets.

Leverage ratio (Basel III) is the ratio of Tier 1 Capital (including AT1) to total exposure (on-balance sheet exposures, derivative exposures, Securities Financing Transaction (SFT) exposures, and Off-Balance Sheet (OBS) items) as calculated per the Authority's Final Basel Rule.

Liquidity Coverage Ratio (LCR) is a calculated measure that ensures banks hold an adequate stock of unencumbered Highly-Quality Liquid Assets (HQLA) that can be converted easily and quickly into cash to meet their liquidity needs over a 30 calendar day liquidity stress scenario period.

Mortgages refer to financing for land and buildings for purchasing real estate estate/residential property.

Mortgages on residential property to total loans refer to mortgages secured by residential properties consisting of homes, apartments, townhouses, and condominiums as a percentage of total loans.

Net charge-offs for loan losses and impaired 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 the 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 changes in the 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 as provided by the banks in their quarterly prudential information returns is the sum of Tier 1 and Tier 2 capital net of applicable 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 shareholder equity over the same period. The average shareholder equity is obtained by averaging the shareholder 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 (RWAs) refer 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: Please 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. A copy of the Guidance is available for download on the Authority's website: www.bma.bm.

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