

Research

Summary:

HSBC Bank Bermuda Ltd.

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Summary:

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SACP	bbb-		+	Support	+3	+	Additional Factors	0
Anchor	bbb-			GRE Support	0		Issuer Credit Rating A-/Negative/A-2	
Business Position	Adequate	0		Group Support	+3			
Capital and Earnings	Very Strong	+2		Sovereign Support	0			
Risk Position	Weak	-2						
Funding	Average	0						
Liquidity	Strong							

Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> • Strategically important subsidiary of HSBC Holdings PLC • Leading competitive position in Bermuda and high share of fee income • Capital ratios that remain very strong, despite recent weakening • Positive, albeit reduced, earnings • Strong liquidity 	<ul style="list-style-type: none"> • Significant deterioration in loan performance in recent years, even compared with Bermuda peers • Concentrated loan portfolio with large single-name exposures • Large recent capital returns to shareholders, in the context of deteriorating loan performance, raise questions about forward-looking risk appetite

Outlook: Negative

Standard & Poor's Ratings Services' outlook on HSBC Bank Bermuda Ltd. (HBBM) is negative, reflecting our concern about ongoing economic weakness in Bermuda and the potential for related loan-quality deterioration at the bank, as well as the negative outlook on the HSBC group parent entity. We expect that nonperforming assets (NPAs), loan loss provisions, and net charge-offs (NCOs) will rise and peak in the 2014-2015 period, the latter at about \$360 million during the two years. If either Bermuda's economy or HBBM's loan performance deteriorates meaningfully beyond our current expectations, or if capital ratios decline materially (for instance, a risk-adjusted capital (RAC) ratio approaching 15%) we might lower the stand-alone credit profile (SACP), and therefore, the rating. We might also lower the rating if, in our view, the supportiveness of HBBM's relationship with HSBC Holdings PLC (HSBC) were to weaken, or we were to downgrade HSBC by two or more notches.

Rationale

The ratings on HBBM, the largest bank in Bermuda, primarily reflect the bank's strategic importance to its parent, HSBC, as well as its leading competitive position in its jurisdiction; "very strong" capital ratios; "weak" risk position; "average" funding profile; and "strong" liquidity profile (as our criteria define these terms). These assessments incorporate HBBM's strong share of the Bermuda market and high fee income, as well as much higher NPAs than peers', which we suspect may reflect weaker underwriting on some loans, in the past.

The bank's RAC ratio remains in our highest category (more than 15%), despite falling since last year. We expect the RAC ratio to edge closer to but remain noticeably above 15%, as we expect the very high dividend payout rates of recent years to not resume until earnings recover from what we expect to be weak profitability in the 2014-2016 period. HBBM's loan performance has deteriorated significantly in recent years. We think the deterioration reflects lagged effects of the multiyear recession Bermuda has been suffering since 2009.

We expect only weak recovery in the Bermudian economy through 2016, and we expect some further weakening in the bank's loan performance throughout this period. We view Bermuda's economy as having substantially deteriorated since 2009, and expect significant lagged impact from this is yet to hit the Bermudian banking sector, particularly in terms of NCOs. However, HBBM's customer loan portfolio is only about one-quarter of its earning assets, thereby mitigating the impact of weaker loan performance on our risk assessment of the bank. We view the bank's geographic concentration of its loans and operations somewhat negatively in our business risk assessment.

The long-term issuer credit rating also reflects our view of HBBM's strategic importance to its parent company, U.K.-incorporated bank holding company HSBC, and our view that it is likely that any extraordinary U.K. sovereign support provided to HSBC would extend to HBBM if needed. The long-term 'A-' rating on HBBM is three notches above the 'bbb-' SACP on the bank and two notches below the 'a+' group credit profile (GCP) on HSBC.

Related Criteria And Research

Related Criteria

- Group Rating Methodology, Nov. 19, 2013
- Revised Market Risk Charges For Banks In Our Risk-Adjusted Capital Framework, June 22, 2012
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010

Related Research

- Banking Industry Country Risk Assessment: Bermuda, Aug. 15, 2014
- Various Rating Actions Taken On Two Bermudian Banks Based On Higher Economic Risk, July 1, 2014
- HSBC Bank Bermuda 'A/A-1' Ratings Placed On CreditWatch Negative On Weaker Loan Performance And Large Capital Payout, March 11, 2014
- Ratings On Bermudian Banks Lowered On Rising Economic Risk; Outlooks Negative, Sept. 26, 2013
- HSBC Bank Bermuda Ltd. Long-Term Rating Lowered To 'A' On Higher Economic Risk; Outlook Is Negative, Sept. 26, 2013

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

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