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Ratings

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HSBC Bank Bermuda Ltd.

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Table Of Contents

HSBC Bank Bermuda Ltd.

SACP	bbb-	+	Support	+3	+	Additional Factors	0

Anchor	bbb-	
Business Position	Adequate	0
Capital and Earnings	Very Strong	+2
Risk Position	Weak	-2
Funding	Average	0
Liquidity	Strong	

ALAC Support	0
GRE Support	0
Group Support	+3
Sovereign Support	0

Issuer Credit Rating
A-/Stable/A-2

Major Rating Factors

Strengths:	Weaknesses:
• Strategically important subsidiary of HSBC Holdings PLC • Leading competitive position in Bermuda • Very strong S&P Global Ratings risk-adjusted capital (RAC) ratio • High-quality liquid assets (HQLA)	• Elevated nonperforming assets (NPAs) versus those of peers • Geographically concentrated loan portfolio, with large single-name exposures • Large capital returns to shareholders on several occasions in the past decade

Outlook: Stable

Our stable outlook on HSBC Bank Bermuda (HBBM) reflects the group's (HSBC Holdings PLC) proclivity to provide extraordinary support to its Bermudian subsidiary and in spite of our recent outlook revision on the group to negative from stable (see "HSBC Holdings PLC Outlook Revised To Negative On Accumulating Threats To Earnings Prospects; 'A/A-1' Ratings Affirmed," published Nov. 12, 2019, on RatingsDirect). Our base case is that group support will not meaningfully weaken during our two-year outlook horizon, and that the group will not extract capital from the bank that causes our RAC ratio to fall below 15%; however, the parent's restructuring plans, with details to be known in February 2020, could lead us to rethink our position. We also expect the bank to maintain good profitability and make gradual progress in reducing its NPAs as a share of loans.

We could raise our ratings on HBBM if we believe that signs of nascent recovery in the local economy will persist, leading to an improvement in the economic risk score in our BICRA assessment and a revision in our anchor for bank ratings in Bermuda to 'bbb' from 'bbb-'. However, we are unlikely to raise the ratings unless we believe that capital payouts to the parent will not increase, in those circumstances, sufficiently to bring our RAC ratio significantly below 15%, asset quality improves significantly, or there is some sign that the group is more committed to Bermuda.

We could lower the ratings if we believe the group's proclivity to support its Bermudian operations will soon meaningfully decline, it extracts dividends from the bank that cause its RAC ratio to fall below 15% regardless of domestic economic conditions, or the bank's asset quality or market share in Bermuda weakens further.

Rationale

We recognize the bank's dominant competitive position in Bermuda, particularly in serving the reinsurance sector. The bank's earnings have been respectable in recent years and its regulatory capital ratios and S&P Global Ratings RAC ratio remain very strong (RAC ratio of 22.3% as of year-end 2018), but in recent years, dividend payouts have exceeded net income. HBBM's loan performance has improved with declining net charge-offs although NPAs remain elevated and less favorable than peers'. On a positive note, funding reflects a mix of core and non-core deposits, with no dependence on wholesale funding. The bank has ample liquidity with a significant investment portfolio of highly rated securities. Finally, it receives three notches of ratings uplift for group support that reflect our view of its strategic importance to its parent company, U.K.-incorporated bank holding company HSBC Holdings PLC (HSBC; A/Negative/A-1).

Anchor: 'bbb-' for a bank operating in Bermuda

We rank the banking sector of Bermuda (A+/Positive/A-1) under our Banking Industry Country Risk Assessment (BICRA) methodology, in BICRA group '5'.

On May 11, 2018, we revised our economic risk trend on Bermuda to positive from stable, in line with our positive outlook on our sovereign rating on Bermuda, the latter also recently revised, from stable. We see encouraging recent economic indicators in Bermuda, including increased visitor traffic, length-of-stay, and spending, combined with a return to positive real growth in GDP in 2017. Concern regarding the negative competitive pressure on Bermuda (a low-tax jurisdiction) from the recent decrease in the U.S. corporate tax rate appears to be fading, and we do not expect en masse departures of the insurers and reinsurers that comprise Bermuda's economic bedrock, although we expect consolidation in those sectors to gradually continue. Major construction projects (such as the airport renovation) are also providing a temporary boost to employment and income. We may improve our economic risk score for Bermuda if we become convinced that the current economic rebound will persist. We continue to view the trend for industry risk as stable.

All figures are as of Dec. 31, 2018, unless otherwise specified.

Table 1

HSBC Bank Bermuda Ltd. -- Key Figures

	--Year ended Dec. 31--				
(Mil. $)	**2018**	**2017**	**2016**	**2015**	**2014**
Adjusted assets	8,077	9,027	9,757	11,992	11,459
Customer loans (gross)	2,324	2,436	2,461	2,569	3,062
Adjusted common equity	795	757	828	1,004	1,063
Operating revenues	280	302	281	304	326
Noninterest expenses	143	139	166	175	184
Core earnings	139	162	96	93	77

Business position: Significant market share in Bermuda

We assess HBBM's business position as adequate, largely supported by its status as the second-largest Bermuda-based bank with a leading competitive position in the jurisdiction. Despite HBBM's small size relative to its parent, HSBC, we believe that its business position greatly benefits from its ownership structure and globally recognized brand. The adequate business position stems from our comparison of HBBM with the entire Bermudian banking system, of which HBBM constitutes a dominant share, with $8.1 billion in total assets.

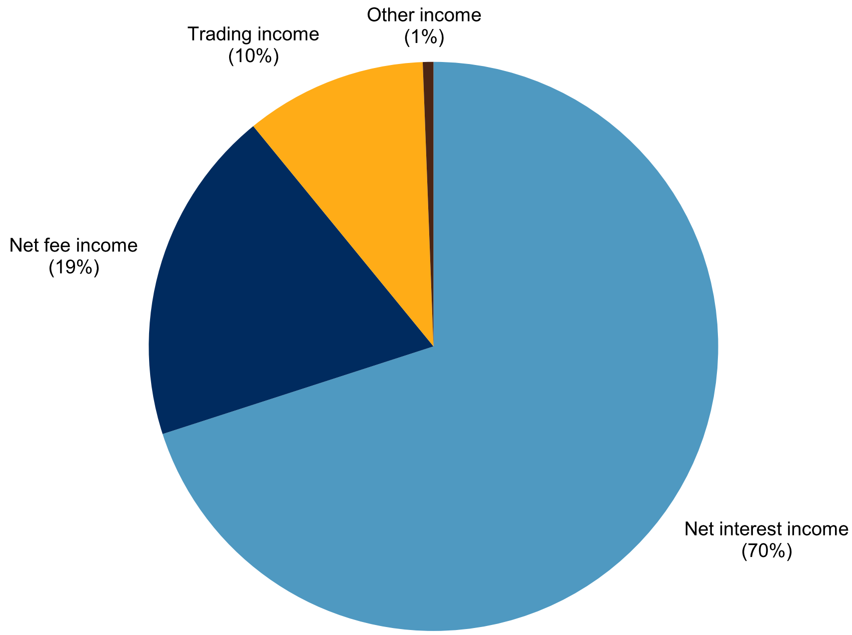
We believe the combination of the resources of the HSBC global network and the long-term local knowledge and well-established local presence of HBBM's predecessor (established in Bermuda in 1889) helps HBBM to maintain its dominance. We estimate that it has a deposit market share of 54% and loans of 45% (which has been stable over the past couple of years) in Bermuda--well more than any of its competitors. Despite its dominant competitive position, our assessment is tempered by the substantial geographic concentration of the bank's lending portfolio and increasing reliance on more volatile spread income.

HBBM's fee income, which we view as less volatile compared with its lending and trading businesses, although up from year-end 2017, has declined in recent years due to the sell-off of some of the bank's subsidiaries. However, we acknowledge management's re-focus on the bank's core businesses in Bermuda, including Retail Banking, Wealth Management, Commercial Banking, and Global Banking and Markets. Despite the 20% contraction in GDP since 2008 and through 2017, HBBM has not reported a loss in any year of the past decade.

HBBM's customer loan portfolio (about 29% of its assets) is geographically concentrated in Bermuda, and has large single-name exposures. In comparison with banks that we view as having similar industry risk, such as those based in the U.S., HBBM is highly dependent on a single industry (global reinsurance).

Chart 1

HSBC Bank Bermuda -- Revenue Sources
(As of Dec. 31, 2018)



Source: Company financial statements, June 2019.

Table 2

HSBC Bank Bermuda Ltd. -- Business Position					
	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Return on average common equity	17.92	20.49	10.23	8.90	6.67

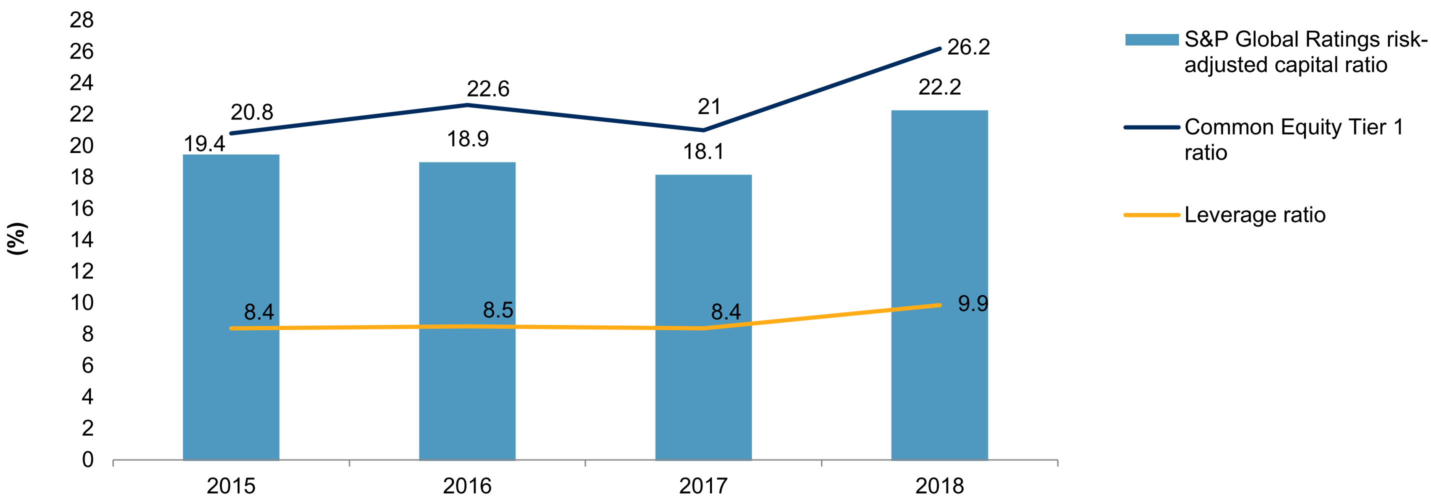
Capital and earnings: Very strong RAC ratio, though at risk to large dividend payments to parent

HBBM's RAC ratio remains very strong (our highest category), at about 22.2%. We expect it will decline somewhat over the next 18-24 months, largely as a result of dividends to the parent, but remain in the very strong category. Our forecast assumes relatively stable earnings and a dividend payout ratio about equal to net income (according to management). We do not rule out the possibility that the parent could again require capital payouts that are substantially in excess of net income, which is typically driven by return on equity targets that it sets. We estimate that a dividend payout of multiple times earnings, as has happened in the past decade, would result in the RAC ratio falling significantly.

HBBM is subject to a capital surcharge in the range of 0.5% to 3%, based on its systemic importance to Bermuda's economy and banking sector. As of Dec. 31, 2018, HBBM's Common Equity Tier 1 capital ratio and total capital ratio were 26.2% and 26.3%, respectively. The bank's adjusted common equity, which is our definition of core capital that eliminates components that we classify as relatively weaker than common equity, represents 100% of its total adjusted capital, in line with the bank's peers'.

Chart 2

HSBC Bank Bermuda Ltd. -- Capital Metrics
As of Dec. 31, 2018



Source: S&P Global Ratings.

Core earnings to operating revenues of 50% is lower than it was at year-end 2017 (54%); however, it is much improved from prior years. The efficiency ratio (expenses to revenues) worsened to 51% from 46% for the same period one year earlier as a result of negative revenue growth; however, the bank's focus on costs has been evident in the past several years, with improvements through 2017. We expect earnings will be somewhat under pressure due to the low interest rate environment; focus on expense control to remain key; and further reduction in loan loss provisions, assuming loan performance stabilizes. We expect HBBM's earnings quality to remain solid based on our projected three-year average earnings buffer of 2.8%, which indicates that the bank has adequate earnings to cover our estimate of normalized loan losses through the cycle.

Table 3

HSBC Bank Bermuda Ltd. -- Capital And Earnings

	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00	100.00
Net interest income/operating revenues	70.65	64.38	67.38	60.99	59.29
Fee income/operating revenues	19.25	16.78	20.13	24.36	26.32
Market-sensitive income/operating revenues	10.10	18.60	12.22	14.40	14.12

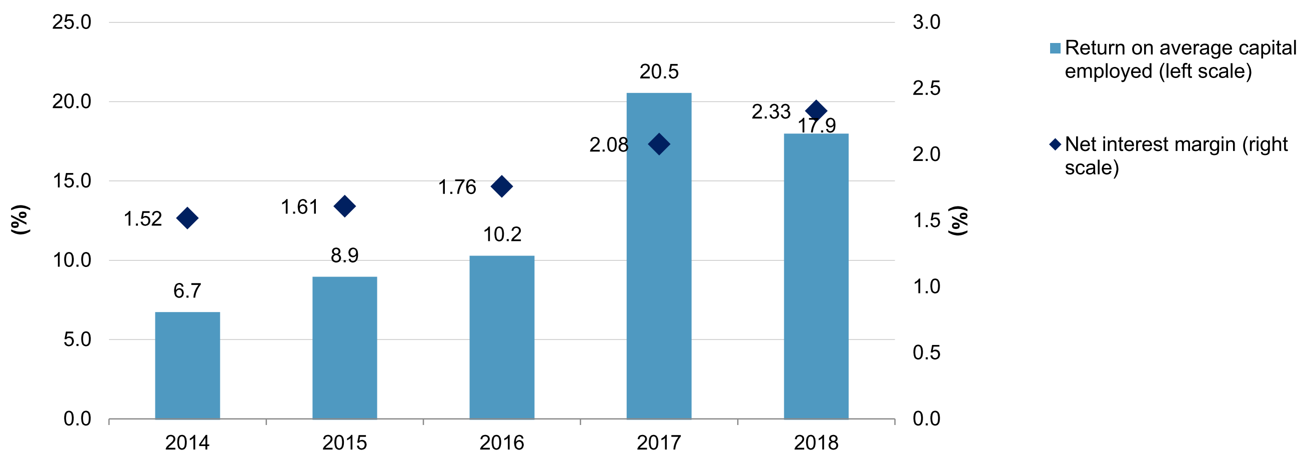
Table 3

HSBC Bank Bermuda Ltd. -- Capital And Earnings (cont.)

	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Noninterest expenses/operating revenues	51.25	46.03	58.90	57.61	56.61
Preprovision operating income/average assets	1.60	1.73	1.06	1.10	1.10
Core earnings/average managed assets	1.63	1.73	0.88	0.79	0.60
S&P Global Ratings' risk-adjusted capital (RAC) ratio before diversification	22.18	18.05	18.88	19.39	17.29

Chart 3

HSBC Bank Bermuda Ltd. -- Profitability Metrics
(As of Dec 31, 2018)



Source: S&P Global Ratings.

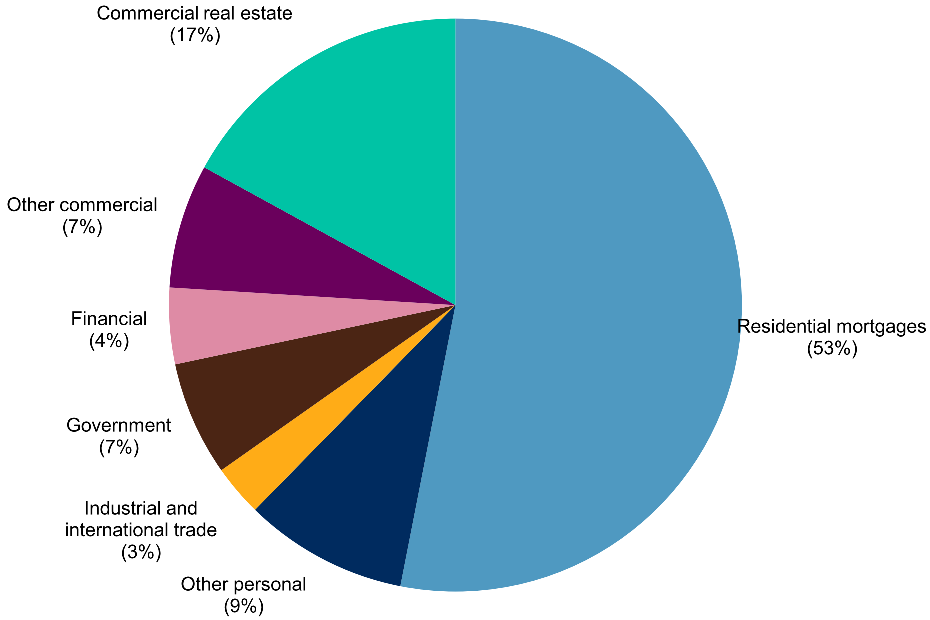
Risk position: Asset quality metrics that are significantly less favorable than peers'

HBBM's risk position is weak, in our opinion. The bank's asset quality performed substantially worse than its local peers' during the past few years, reflecting both Bermuda's weakening economy and challenges in the bank's commercial loan portfolio--including large, single-name exposures. For example: by our measure, NPAs as a share of loans, for the Bermudian banking industry as a group were 5.5% in 2018, which compares with 21% (19% at year-end 2017) for HBBM. Net charge-offs, at 46 bps, are much reduced from several years ago. We expect some improvement in credit quality metrics as prior credit impairment is resolved and the economy continues to expand.

Chart 4

HSBC Bank Bermuda Ltd. -- Loan Portfolio Breakdown

(As of Dec. 31, 2018)

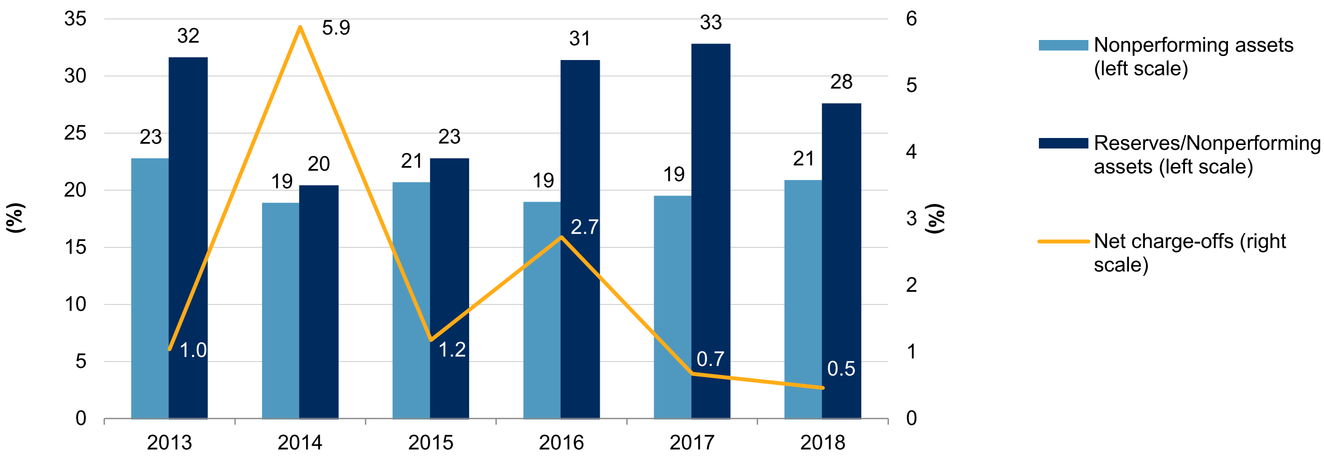


Source: Company annual statement.

The bank's customer loan portfolio was about 29% of its total assets, providing some cushion to earnings and capital, despite relatively weak loan performance. It is largely concentrated in residential mortgages, which represented more than half of the bank's gross loans and advances to customers. We understand many residential mortgage borrowers rely on rental income from non-Bermudian workers (ownership of real estate below a price threshold is restricted to Bermudians), and rental income has suffered as local economic deterioration has reduced both employment and related incomes. The mortgage portfolio experienced large losses between 2012 and 2015 mainly due to the recession and origination practices from 2005 to 2010, which we believe to have since tightened. HBBM is also exposed to credit risk through its investments in securities portfolios and loans to banks. However, these portfolios are well diversified by geography and are highly rated.

Chart 5

HSBC Bank Bermuda Ltd. -- Asset Quality Metrics
(As of Dec. 31, 2018)



Source: S&P Global Ratings.

Table 4

HSBC Bank Bermuda Ltd. -- Risk Position					
	--Year ended Dec. 31--				
(%)	2018	2017	2016	2015	2014
Growth in customer loans	(4.56)	(1.03)	(4.21)	(16.09)	(8.04)
Total managed assets/adjusted common equity (x)	10.16	11.93	11.79	11.95	10.78
New loan loss provisions/average customer loans	(0.11)	0.03	0.77	1.28	2.01
Net charge-offs/average customer loans	0.46	0.66	2.67	1.18	5.88
Gross nonperforming assets/customer loans + other real estate owned	20.84	19.42	22.10	20.61	18.80
Loan loss reserves/gross nonperforming assets	27.53	32.73	31.32	22.72	20.34

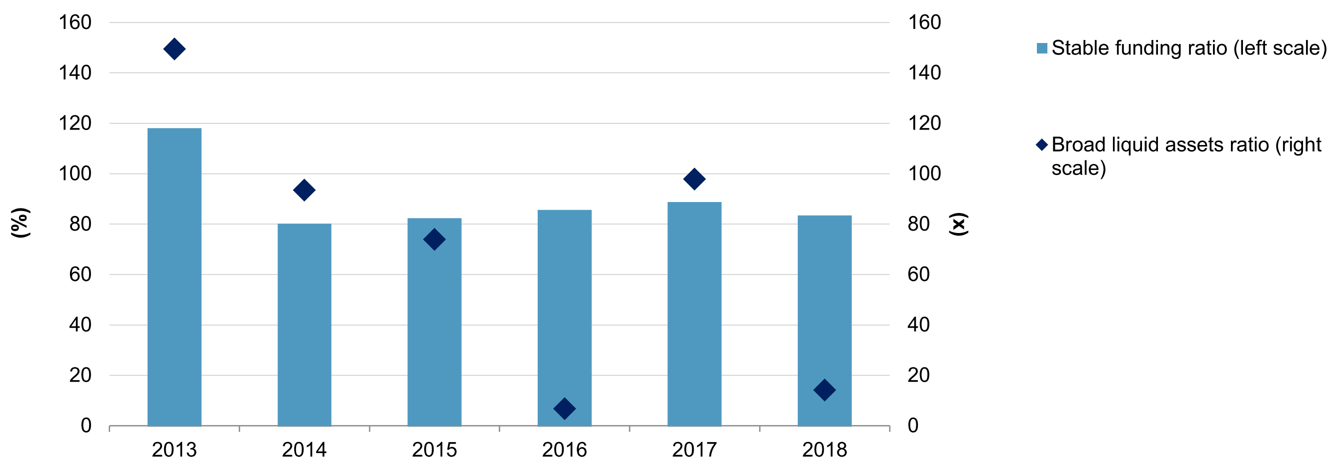
Funding and liquidity: Funding is adequate though slightly less favorable than peers'; liquidity is strong, supported by a significant proportion of liquid and high-quality assets

The bank's funding profile in our opinion, is average for a Bermudian bank but its liquidity profile is strong (better than the average Bermudian bank). Historically, Bermudian banks have realized the need to maintain more conservative funding and liquidity profiles than they otherwise might because Bermuda has no lender of last resort and has had no deposit insurance. However, the local authorities implemented the latter in August 2016. Although coverage is very limited at only B$25,000 per insured depositor for Bermuda-based depositors, we understand this is sufficient to insure the vast majority of Bermuda-dollar retail accounts. In addition, there is no Bermudian debt market, so any potential capital markets funding must come from abroad (accounted for via our BICRA).

HBBM's stable funding ratio (S&P Global Ratings' calculation) is about 83%, and less favorable than the peer average of 112%. Core deposits to the funding base, at 39%, also is below the peer average of 76%. Other than deposits, the bank does not make use of wholesale funding, which we view positively and which offsets its less-than-favorable funding ratios versus peers'.

Chart 6

HSBC Bank Bermuda Ltd. -- Funding And Liquidity metrics
(As of Dec. 31, 2018)



Source: S&P Global Ratings.

HBBM maintains a large securities portfolio (over 40% of assets) that provides a secondary source of liquidity that is ample in size (more than 40% of total assets) and of high quality. Broad liquid assets cover short-term wholesale funding by about 14x.

Table 5

HSBC Bank Bermuda Ltd. -- Funding And Liquidity

	--Year ended Dec. 31--				
(%)	**2018**	**2017**	**2016**	**2015**	**2014**
Core deposits/funding base	38.39	38.11	33.71	34.51	27.14
Customer loans (net)/customer deposits	79.38	73.58	77.44	76.81	106.44
Long-term funding ratio	44.52	43.38	39.42	40.93	34.02
Stable funding ratio	83.08	88.47	85.24	81.99	79.84
Short-term wholesale funding/funding base	3.74	0.59	8.95	1.01	0.70
Broad liquid assets/short-term wholesale funding (x)	14.15	97.94	6.77	73.99	93.52
Net broad liquid assets/short-term customer deposits	159.97	186.91	191.64	268.14	297.52
Short-term wholesale funding/total wholesale funding	6.06	0.95	13.51	1.55	0.96

Support: HBBM is strategically important to its parent

We view HBBM as a strategically important subsidiary of HSBC. Supporting factors include that HBBM is a wholly-owned subsidiary of HSBC (purchased on Feb. 18, 2004); it has a leading market position within Bermuda; it changed its legal name in 2010 to include HSBC; and we think customers' belief that HSBC stands behind its subsidiaries is important to HSBC's global franchise.

On the other hand, HBBM is not in one of the group's priority growth markets; its connectivity with the rest of the group appears more limited than for subsidiaries in larger exporting economies; and it is relatively small, representing only about 1% of group capital. Also, considering the recent restructuring announcement at the parent, we do not rule out the possibility that the supporting factors may weaken in the future.

All things considered, we do not assume HBBM is among those subsidiaries most important to HSBC, but we do believe it to have strategically important group status. As a result, the 'A-' rating on HBBM is three notches above the 'bbb-' SACP on the bank and two notches below our 'a+' group SACP.

Additional rating factors: None

No additional factors support this rating.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

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-

Ratings Detail (As Of November 25, 2019)*

HSBC Bank Bermuda Ltd.	
Issuer Credit Rating	A-/Stable/A-2
Issuer Credit Ratings History	
19-Feb-2019	A-/Stable/A-2
01-Jul-2014	A-/Negative/A-2
11-Mar-2014	A/Watch Neg/A-1
Sovereign Rating	
Bermuda	A+/Positive/A-1
Related Entities	
HSBC Holdings PLC	
Issuer Credit Rating	A/Negative/A-1
Preference Stock	BBB-
Senior Unsecured	A
Senior Unsecured	AA-
Short-Term Debt	A-1
Subordinated	BBB+

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.