

RatingsDirect®

HSBC Bank Bermuda Ltd.

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Related Criteria

HSBC Bank Bermuda Ltd.

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

Credit Highlights

Overview

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

Very strong S&P Global Ratings RAC ratio would be somewhat pressured should there be a special dividend to the parent and the expectation of higher risk-weighted assets (RWA) growth. HSBC Bank Bermuda (HBBM) maintains very strong regulatory capital and S&P Global Ratings RAC ratios, with Common Equity Tier 1 and S&P Global Ratings RAC ratios of 24.7% and 22.5%, respectively, at year-end 2020. We expect our forecast RAC ratio (within the next 18-24 months) to be somewhat pressured by expected higher RWA growth, mainly from expansion in the bank's international lending business and a potential special dividend to the parent in 2021. However, we believe the RAC ratio will be comfortably above our 15% threshold for a very strong score.

Net charge-offs (NCOs) could rise, though not significantly, because loans that remain on deferral are down substantially. HBBM's asset quality metrics weakened in 2020 from 2019, though higher NCOs mostly reflected one-offs. We do not expect a significant rise in NCOs, as customers are back to payment status for those that requested deferrals and exposure to high-risk sectors is manageable, in our view, with most of these sectors picking up again due to the rebound in economy activity, including tourism.

Profitability likely will be similar to 2020. We expect 2021 operating results to be close to 2020's, reflecting declining provisions for loan losses as economic and credit conditions have significantly improved. However, the low interest rate environment remains a strong headwind to operating performance.

Outlook: Stable

S&P Global Ratings' stable outlook on HBBM reflects its expectation that the bank will maintain its strategic importance to the HSBC group, as a fully owned subsidiary sharing the parent's name, making it likely to receive group support in most foreseeable circumstances if needed.

We also expect the bank over the next two years to keep very strong capital--without paying any outside dividends to the parent that would cause its S&P Global Ratings RAC ratio to fall very sharply or below 15%. We believe the company's high capital levels and good efficiency should help it maintain a stand-alone credit profile (SACP) of 'bbb-', even as it copes with possibly higher loan losses and low interest rates.

Downside scenario

We could lower the ratings--by reducing or eliminating the three group support notches we incorporate in them--if we believe the group's proclivity to support its Bermudian operations will meaningfully decline. For instance, that could occur if there was an indication that its parent, HSBC Holdings PLC (HSBC; A-/Stable/A-2), intended to exit Bermuda. We would also lower the ratings on the bank if we lowered our group SACP (a) and ratings on HSBC.

In addition, we could lower the ratings if the bank's SACP weakens. That could occur if HSBC extracts substantial dividends from the bank, particularly while credit losses spike.

Upside scenario

We view the probability of an upgrade as very low because it would require either higher group status than strategically important or both a higher bank SACP and group SACP. That's because we cap the ratings on strategically important subsidiaries one notch below the SACPs of their groups.

Anchor: 'bbb-' For A Bank Operating In Bermuda

We rank the banking sector of Bermuda under our Banking Industry Country Risk Assessment (BICRA) methodology, in BICRA group '5'. As a result, our anchor for a bank operating with a significant presence in Bermuda is 'bbb-'.

Bermuda's economic risk trend is stable, in line with the outlook on our sovereign rating on Bermuda. While the tourism sector took a hit from COVID-19 pandemic-related travel restrictions in 2020, the territory's strong international financial services sector lends overall stability to the economy. Overall, Bermuda's per capita GDP remains one of the highest in the world. Bermuda's property market, which remains in a prolonged correction phase, remains a drag on our assessment of economic risk. We continue to view the industry risk trend as stable. Bermuda has made progress towards improving regulation and governance as indicated by the European Union's February 2020 decision to move Bermuda to its whitelist, indicating the territory's compliance with tax good governance principles.

Business Position: Significant Market Share Position In Bermuda

HBBM's business position is 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, we believe that its business position greatly benefits from its ownership structure and globally recognized brand. The business position also reflects

our comparison of HBBM with the entire Bermudian banking system, of which HBBM constitutes a dominant share, with \$9.1 billion in total assets. However, it is geographically concentrated, which limits its business position to adequate.

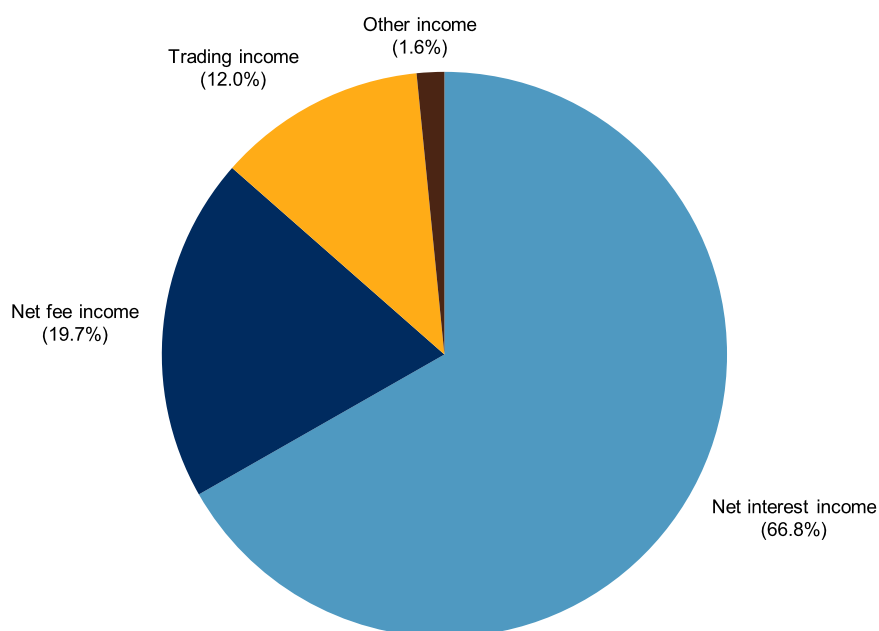
The corporate strategy aims to expand the international lending business, as opportunities are fewer in Bermuda. Nevertheless, the bank remains focused on its core businesses in the territory, including retail banking, wealth management, commercial banking, and global banking and markets. The bank also is emphasizing cost optimization and further streamlining and simplifying its processes and platforms. We believe this will be a long-term strategy and thus, benefits to operating performance will take time and are likely to be incremental.

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 leading competitive market position. We estimate that the bank has a deposit market share of 56% and loans of 42% in Bermuda--considerably more than any of its competitors except Bank of N.T. Butterfield & Son Ltd., which holds the No. 1 market share position (by consolidated assets). Despite HBBM's dominant competitive position, our assessment is tempered by the substantial geographic concentration of the bank's lending exposure and higher-than-historical reliance on more-volatile spread income.

HBBM's fee income (19% of operating revenues), which we view as less volatile than its lending and trading businesses, has declined over the years (40% in 2009) due to the sell-off of some of the bank's subsidiaries.

Chart 1

HSBC Bank Bermuda Ltd. -- Revenue Sources
(As of Dec. 31, 2020)



Source: Company financial statements.
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HBBM's customer loan portfolio (23% of its assets) is small, 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).

Capital And Earnings: Very Strong RAC Ratio, But The Bank Pays Large Dividends To The Parent

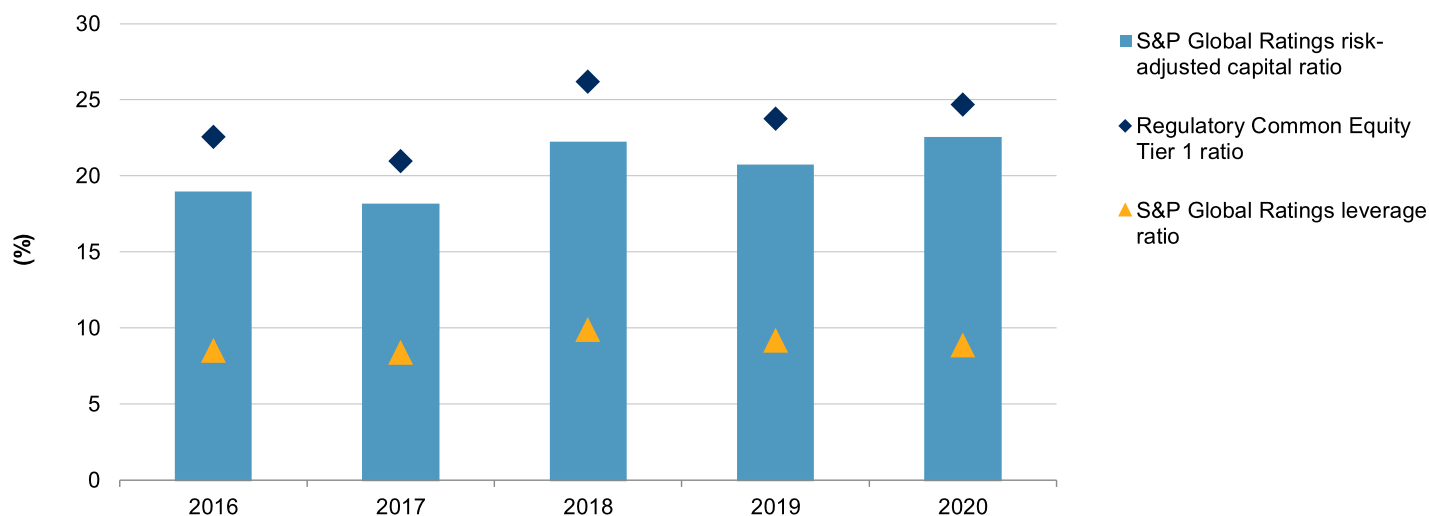
We view HBBM's capital and earnings as benefiting from a high level of equity relative to its fairly small loan portfolio and considerable, highly rated investments. The bank's S&P Global Ratings RAC ratio was 22.5% at year-end 2020, by our calculation, which is well above our very strong threshold of 15%. 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.

Historically, the parent has required capital payouts that substantially exceeded net income, which are typically driven by return on equity targets set at the group level. In 2021, HBBM may pay a special dividend to the parent that is likely to exceed expected net income. However, we estimate that the 2021 RAC ratio will remain well above our 15% threshold. Our forecast RAC also reflects a dividend payout ratio to the parent of 100% in 2022 and 2023, stable provisions for loan losses, continued pressure on the net interest margin limiting profitability, and higher RWA growth

in line with loan growth, particularly in the international lending business. We do not rule out the possibility of a second special dividend to the parent in 2022 and 2023. Should there be one, the possibility of the forecast RAC ratio breaching the 15% threshold would increase.

Chart 2

HSBC Bank Bermuda Ltd. -- Capital Metrics
As of Dec. 31, 2020



Source: S&P Global Ratings.

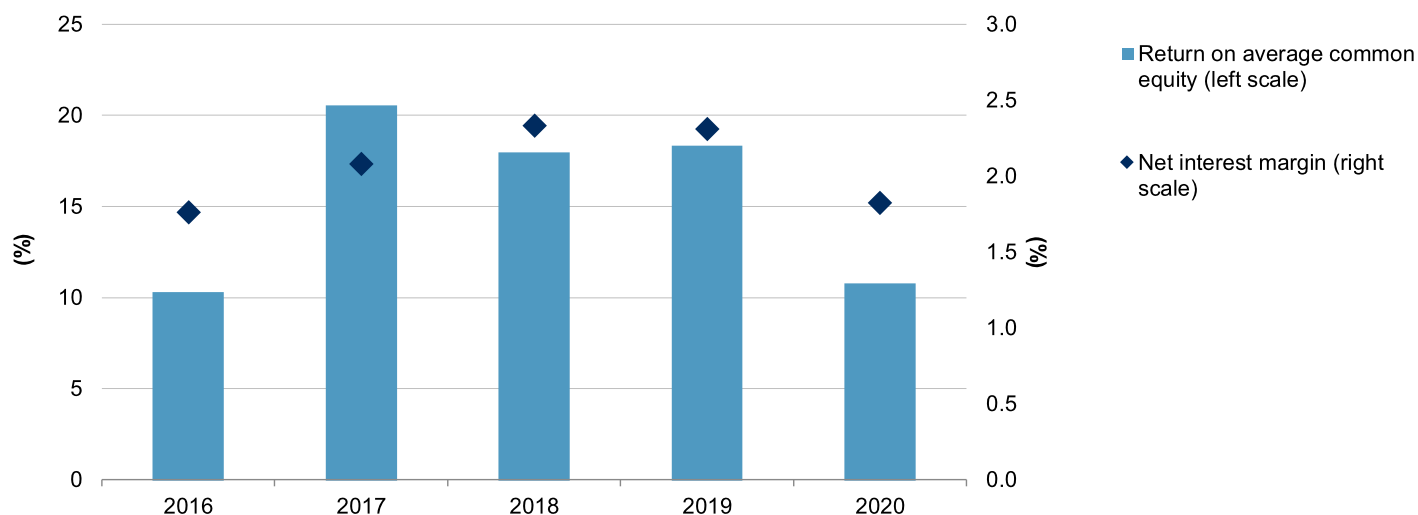
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The bank's adjusted common equity, which is our definition of core capital that eliminates components we classify as relatively weaker than common equity, represents 100% of total adjusted capital, in line with that of peers. We estimate that the bank will maintain a three-year average earnings buffer of 2.6% of risk-adjusted assets, indicating a strong earnings cushion based on its standard over-the-cycle loss assumptions.

Core earnings to operating revenues of 35% declined from 51% at year-end 2019 due to a significant rise in provisions for loan losses (up 355% from 2019) in 2020 and reflected the pandemic and lockdowns. Earnings were also affected by low interest rates, which was an even bigger driver than provision charges. First-quarter 2021 benefited from a reversal in provisions from one year ago. The efficiency ratio (expenses to revenues), which we consider strong, weakened slightly to 48.3% from 46.1% for the same period one year ago as a result of negative revenue growth; however, the bank's focus on cost containment remains evident with improvements since 2017. HBBM has several initiatives in place to further reduce costs and help profitability.

Chart 3

HSBC Bank Bermuda Ltd. -- Profitability Metrics
(As of Dec. 31, 2020)



Source: S&P Global Ratings.

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Risk Position: NPAs Are Significantly Higher Than Peers' Though Loan Losses Could Rise Only Modestly

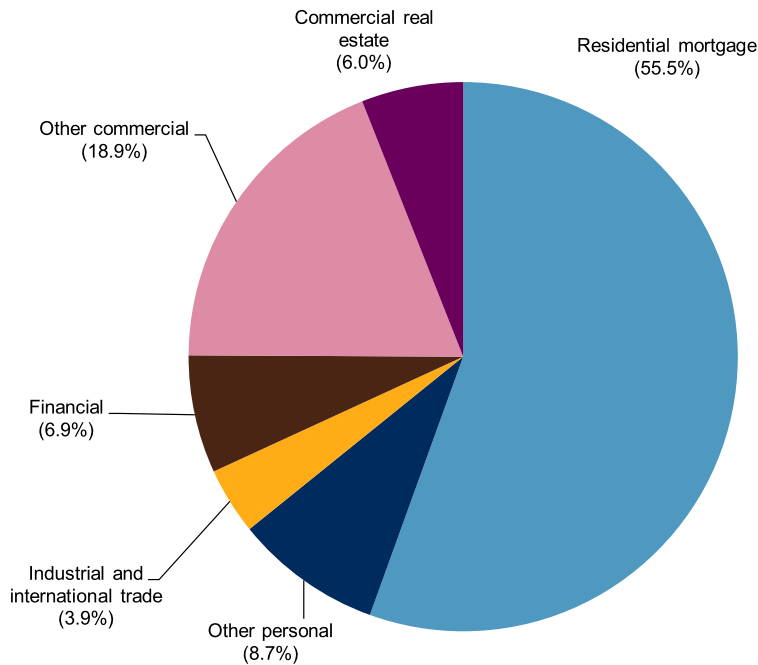
Our assessment of the bank's risk position considers asset quality that performed substantially worse than its local peers' during the past few years, reflecting both Bermuda's weak economy (pre-pandemic) and challenges in the bank's residential mortgage and commercial loan portfolios—including large, single-name exposures. We expect any remaining fallout from the pandemic could materialize in a modest increase in NCOs, as loans that remain on deferral are down to a very small percentage of loans.

Loans represent a modest 23% of total assets. HBBM's gross NPAs to customer loans ratio was 21%, up from 16% in 2019. The very high ratio reflects the fact that in Bermuda, the cure period for nonperforming loans is very long. Although half of NPAs are not delinquent, they remain in NPA status until cured. NCOs, which historically also have been higher than those of peers, were 102 basis points (bps), up from 60 bps in 2019, and which reflected primarily one-offs. Residential mortgages represent the largest component of loans at 56%. HBBM's mortgage portfolio reported large losses between 2012 and 2015, mainly due to the recession during 2009-2013. We believe that the bank's underwriting practices in residential mortgages include appropriate documentation and income verification of borrowers at the time of their origination. Homeowners reliant on rental income from non-Bermudian workers (ownership of real estate below a price-threshold is restricted to Bermudians) are in better shape today as economic activity has picked up. Also, house prices are holding up well. Other consumer loans are modest (less than 9% of

loans).

Chart 4

HSBC Bank Bermuda Ltd. -- Loan Portfolio Breakdown
(As of Dec. 31, 2020)



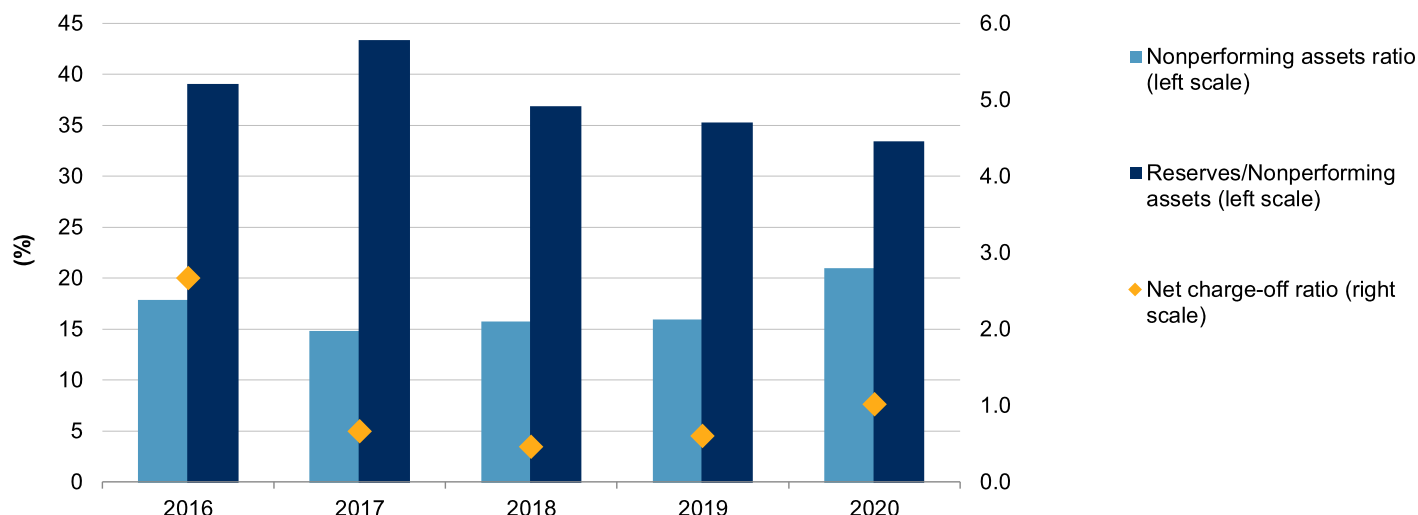
Source: Company annual statements.

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The bank is exposed to some sectors that were hit early in the pandemic, though exposure represents a modest percentage of the business loan book. We do not expect outside losses, as most of these sectors are recovering as the economy strengthens. Also, the loan portfolio is small relative to assets. Commercial real estate loans represented only 6% of total loans. The exposure is significantly lower than that of most rated U.S. regional banks. Commercial loans (about 23% of loan; includes industrial and international trade and other commercial loans), however, include sizable single-name exposures to several types of borrowers, which makes the bank more vulnerable to larger losses. HBBM is also exposed to credit risk through its investments in securities and loans to banks. However, these holdings are well diversified by geography and are highly rated.

Chart 5

HSBC Bank Bermuda Ltd. -- Asset Quality Metrics
(As of Dec. 31, 2020)



Source: S&P Global Ratings.

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Funding And Liquidity: Funding Is Average For A Bermudian Bank And Liquidity Is Strong

HBBM's funding profile is appropriate for a Bermudian bank. Its liquidity profile, on the other hand, is strong (better than the average Bermudian bank). Historically, Bermudian banks have maintained more conservative funding and liquidity profiles than they otherwise might; we believe this is because Bermuda has no lender of last resort and has had no deposit insurance. However, 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 most 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).

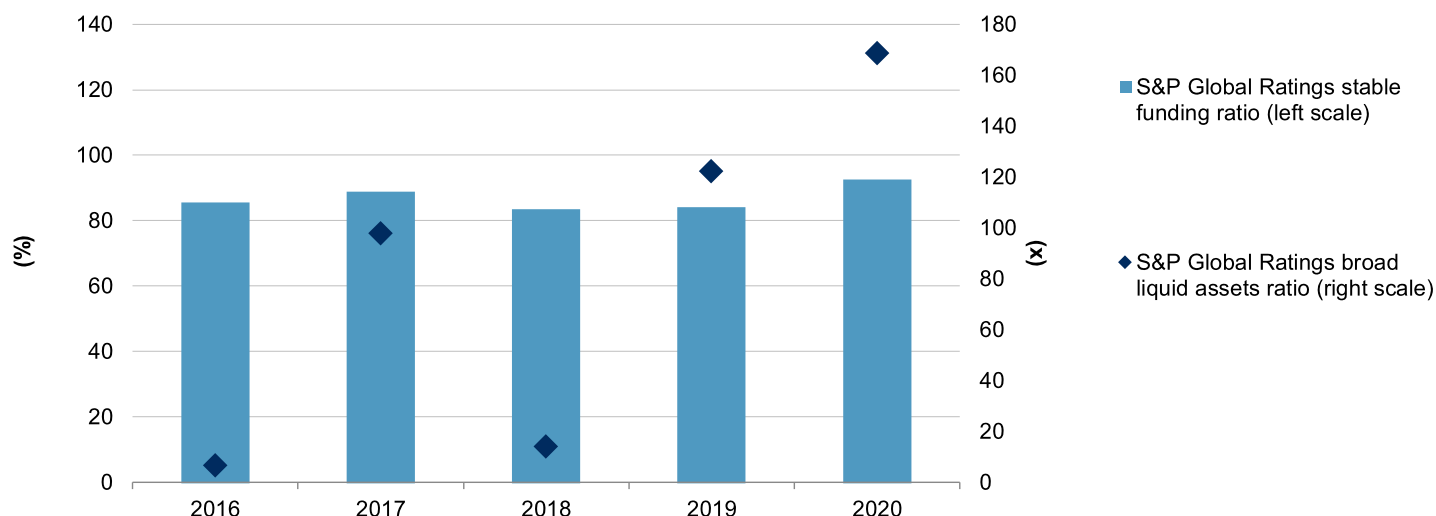
The Bermudian government, unlike many governments in other jurisdictions, did not put in place funding and liquidity facility programs early in 2020 (at the height of the pandemic) for banks to continue to provide credit to customers in need. That is because it believes that the Bermudian banks have ample liquidity and are highly capitalized and thus, able to extend credit. We believe that the government would step in and provide support if the Bermudian banks were to run into funding and liquidity constraints. The pandemic proved not to be an issue for the bank as it continued to provide credit to its customers.

HBBM's stable funding ratio (S&P Global Ratings' calculation) at 92% is less favorable than the peer average of 134%.

Core deposits to the funding base, at 39%, is also below the peer average of 78%. 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, 2020)



Source: S&P Global Ratings.

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HBBM has a large securities portfolio (49% of assets) that provides a secondary source of liquidity that is ample and of high quality. Liquid assets consist of cash, money market, and highly rated investments. The bank's very high level of liquid assets translates into broad liquid assets to short-term wholesale funding of 169x compared with the peer average 72x, and, in our view, is very strong. The securities portfolio is large because there are fewer opportunities to lend.

Support: Three Notches Of Uplift Given Our View Of HBBM's Strategic Importance To Its Parent

We view HBBM as a strategically important subsidiary of HSBC. Supporting our view is that HBBM is a wholly owned subsidiary of HSBC (purchased on Feb. 18, 2004); it has a leading market position in 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, 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 one notch below our 'a' group SACP.

Environmental, Social, And Governance

Governance and environmental factors feature more prominently in our credit analysis of HSBC Bermuda than the social factor. We believe HSBC Bermuda's corporate governance is on par with that of peers and is an extension of its parent's. We consider the bank's risk appetite to be relatively conservative and risk management controls to be appropriate. From an environmental standpoint, the bank is exposed to natural disasters such as hurricanes and rising sea levels; however, the infrastructure on the island of Bermuda is built to withstand such occurrences. Historically, the bank has not been affected by natural disasters from an operating performance and lending standpoint. From a social standpoint, the bank has not experienced any policy failures that would jeopardize its reputation or its customers.

Key Statistics

Table 1

HSBC Bank Bermuda Ltd. -- Key Figures					
--Fiscal year-end Dec. 31--					
(Mil. \$)	2020	2019	2018	2017	2016
Adjusted assets	9,052	8,378	8,077	9,027	9,757
Customer loans (gross)	2,080	2,303	2,324	2,436	2,461
Adjusted common equity	802	768	795	757	828
Operating revenues	238	281	280	302	281
Noninterest expenses	115	129	143	139	166
Core earnings	84	143	139	162	96

Table 2

HSBC Bank Bermuda Ltd. -- Business Position					
--Fiscal year-end Dec. 31--					
(%)	2020	2019	2018	2017	2016
Return on average common equity	10.72	18.27	17.92	20.49	10.23

Table 3

HSBC Bank Bermuda Ltd. -- Capital And Earnings					
--Fiscal year-end Dec. 31--					
(%)	2020	2019	2018	2017	2016
S&P Global Ratings' risk-adjusted capital ratio before diversification	22.5	20.7	22.2	18.1	18.9
Adjusted common equity/total adjusted capital	100.00	100.00	100.00	100.00	100.00
Net interest income/operating revenues	65.81	66.84	70.65	64.38	67.38
Fee income/operating revenues	19.44	19.67	19.25	16.78	20.13

Table 3

HSBC Bank Bermuda Ltd. -- Capital And Earnings (cont.)					
	--Fiscal year-end Dec. 31--				
(%)	2020	2019	2018	2017	2016
Market-sensitive income/operating revenues	13.33	13.52	10.10	18.60	12.22
Cost to income ratio	48.32	46.05	51.25	46.03	58.90
Preprovision operating income/average assets	1.41	1.84	1.60	1.73	1.06
Core earnings/average managed assets	0.97	1.74	1.63	1.73	0.88

Table 4

HSBC Bank Bermuda Ltd. -- Risk Position					
	--Fiscal year-end Dec. 31--				
(%)	2020	2019	2018	2017	2016
Growth in customer loans	(9.67)	(0.94)	(4.56)	(1.03)	(4.21)
Total managed assets/adjusted common equity (x)	11.29	10.91	10.16	11.93	11.79
New loan loss provisions/average customer loans	1.79	0.37	(0.11)	0.03	0.77
Net charge-offs/average customer loans	1.02	0.60	0.46	0.66	2.67
Gross nonperforming assets/customer loans + other real estate owned	20.90	15.83	15.61	14.70	17.78
Loan loss reserves/gross nonperforming assets	33.30	35.15	36.76	43.24	38.93

Table 5

HSBC Bank Bermuda Ltd. -- Funding And Liquidity					
	--Fiscal year-end Dec. 31--				
(%)	2020	2019	2018	2017	2016
Core deposits/funding base	39.37	38.26	38.39	38.11	33.71
Customer loans (net)/customer deposits	60.63	75.73	79.38	73.58	77.44
Long-term funding ratio	44.82	43.98	44.52	43.38	39.42
Stable funding ratio	92.19	83.75	83.08	88.47	85.24
Short-term wholesale funding/funding base	0.34	0.44	3.74	0.59	8.95
Broad liquid assets/short-term wholesale funding (x)	168.78	122.22	14.15	97.94	6.77
Net broad liquid assets/short-term customer deposits	183.73	174.53	159.97	186.91	191.64
Short-term wholesale funding/total wholesale funding	0.57	0.71	6.06	0.95	13.51

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- 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 Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- 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 July 28, 2021)*

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+/Stable/A-1
Related Entities	
HSBC Bank PLC	
Issuer Credit Rating	A+/Stable/A-1
Resolution Counterparty Rating	AA-/--/A-1+
Commercial Paper	A-1
Junior Subordinated	BBB

Ratings Detail (As Of July 28, 2021)*(cont.)

Senior Unsecured	A+
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.

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