S&P Global Ratings

RatingsDirect®

HSBC Bank Bermuda Ltd.

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HSBC Bank Bermuda Ltd.

SACP	bbb-

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

+

Support	+3

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

+

Additional Factors	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 • Large proportion of high-quality liquid assets	• 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

S&P Global Ratings' stable outlook on HSBC Bank Bermuda (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 outsize 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 weak asset quality, low rates, and the difficult operating conditions related to the COVID-19 pandemic.

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), wished 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 if credit losses spike amid a weak economy.

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

Rationale

Our ratings on HBBM reflect our view that it is a strategically important subsidiary of the HSBC group, likely to receive support from the group in most foreseeable circumstances. Given that view, we add three notches to the 'bbb-' SACP we have assigned to HBBM.

That said, we believe it has less strategic importance to HSBC than the group's core subsidiaries, which we see as even more integral to the group and more likely to receive extraordinary support. We rate those entities in line with the group's SACP.

Our SACP on HBBM factor in our expectation that the bank will be able to maintain a relatively strong balance sheet throughout the ongoing economic downturn caused by COVID-19, including its very strong capital. Although we expect significant Bermuda-wide pressure on asset quality metrics will continue due to the downturn, we believe that the bank is in a good position to absorb future losses because of its good efficiency and high capital.

We expect capital ratios could come under pressure from significantly higher provisions for loan losses and much weaker operating performance. Still, we expect the bank's RAC ratio will remain in our very strong range above our threshold of 15% over the next 18 to 24 months. We expect HBBM's liquidity to remain strong, reflecting the bank's strong retail and business deposit franchise and sizable, liquid investments.

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-'.

Earlier in the year, we revised our economic risk trend on Bermuda to stable from positive, in line with our outlook revision to stable on our sovereign rating on Bermuda. We expect that travel restrictions in light of the global pandemic pushed Bermuda into a deep economic contraction in 2020, notwithstanding the reopening of international travel in July and the stability lent to Bermuda's economy by its strong international financial services (IFS) sector. We also believe that Bermuda's property market will remain in a correction phase, although it could experience near-term stabilization because of government efforts to attract foreign remote workers. We continue to view the trend for industry risk as stable. We view the EU's February 2020 decision to move Bermuda to its whitelist, indicating the island's compliance with tax good governance principles owing to reforms undertaken by the government, as a positive rating factor.

Figures and ratios are as of Dec. 31, 2019, unless otherwise specified.

Table 1

HSBC Bank Bermuda Ltd.--Key Figures					
	--Fiscal year-end Dec. 31--				
(Mil. $)	**2019**	**2018**	**2017**	**2016**	**2015**
Adjusted assets	8,378.3	8,076.8	9,027.2	9,757.3	11,992.4
Customer loans (gross)	2,302.6	2,324.4	2,435.5	2,460.8	2,568.8
Adjusted common equity	767.6	794.9	756.5	827.5	1,003.9
Operating revenues	280.5	280.0	301.9	281.0	304.2
Noninterest expenses	129.2	143.5	139.0	165.5	175.3
Core earnings	142.8	139.0	162.3	96.2	92.8

Business position: Significant market share in Bermuda

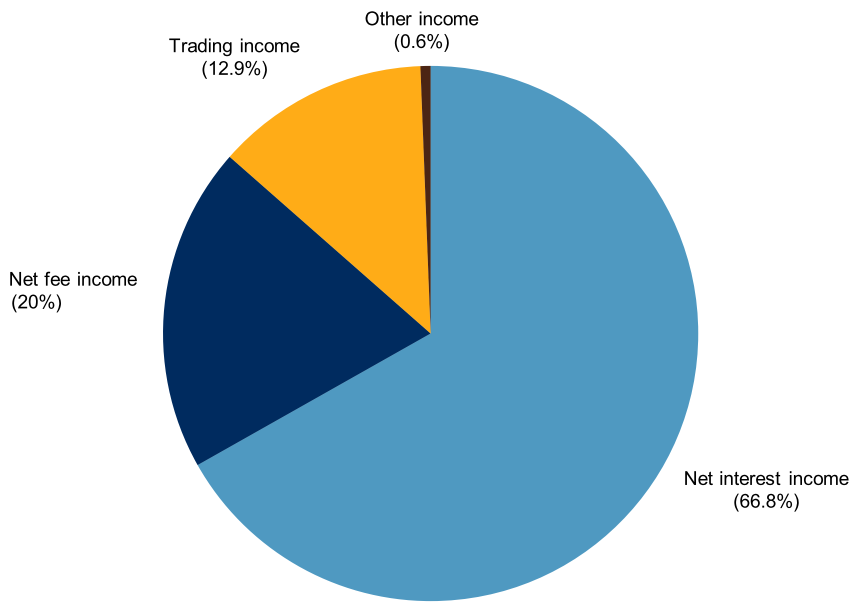
We assess HBBM's business position as adequate, largely supported by its status as the second-largest Bermuda-based bank with a leading competitive position in the jurisdiction. Despite HBBM's small size relative to its parent, HSBC, we believe that its business position greatly benefits from its ownership 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 $8.4 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 leading competitive market position. We estimate that it has a deposit market share of 54% and loans of 45% (which have been stable over the past several years) in Bermuda--considerably 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 exposure and higher-than-historical reliance on more-volatile spread income.

HBBM's fee income (20% of operating revenues), which we view as less volatile than 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 focus on the bank's core businesses in Bermuda, including retail banking, wealth management, commercial banking, and global banking and markets.

Chart 1

HSBC Bank Bermuda -- Revenue Sources
(As of Dec. 31, 2019)



Source: Company Financial Statements, Dec. 2019

HBBM's customer loan portfolio (about 27% of its assets) is small and 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).

HSBC, the parent, expects to complete an ambitious restructuring plan over the next three years. In our view, despite the diversity of HSBC's operations by geography and customer segments, the group will not be fully shielded from the global economic downturn triggered by the measures taken to curb the spread of COVID-19. In our view, weaker earnings that will arise from higher credit charges will be exacerbated by the lower-than-anticipated interest rate environment. We see muted earnings prospects and extensive restructuring by the parent as key challenges. However, we expect HSBC's relatively strong balance sheet and diversified loan exposures will likely leave it resilient even if economic risks rise across several of its key regions (see the analysis published May 26, 2020, on RatingsDirect).

Table 2

HSBC Bank Bermuda Ltd.--Business Position					
	--Fiscal year-end Dec. 31--				
(%)	2019	2018	2017	2016	2015
Return on average common equity	18.3	17.9	20.5	10.2	8.9

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

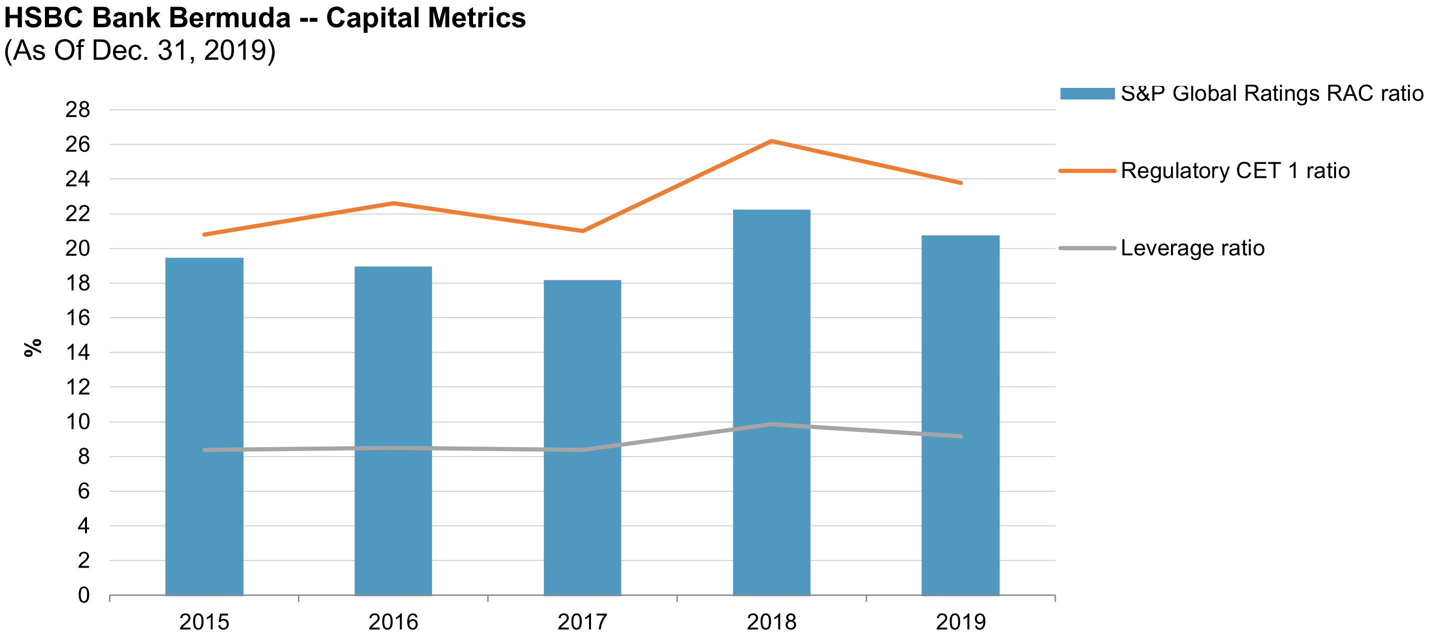
We view HBBM's capital and earnings as very strong, with a high level of equity relative to its fairly small loan portfolio and considerable, highly rated investments. The company's RAC ratio was 20.7% at year-end 2019, by our calculation, which is well above our very strong threshold of 15%. We do not 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 substantially higher than HBBM's net income, as has happened in the past decade, could result in the RAC ratio falling significantly.

We expect the RAC ratio in 2020 to be higher than in 2019, assuming the company does not pay a large dividend to HSBC during the remainder of the year. Nevertheless, we expect earnings will decline meaningfully due to the recession and to reflect much higher provisions for loan losses due to the deteriorating credit environment. We expect net interest income will be materially affected by low market interest rates. We expect margin compression to reflect the bank's substantial securities and maturities that are being replaced with lower-yielding bonds and higher refinancing activity, given lower interest rates. We believe that fee income could be negatively affected by reduced card spending and lower account service fees. We believe that RWA growth could be higher 2021 and 2022 should loan growth pick up. We assume a dividend payout ratio (to the parent) of 100% through 2022. We assume that HBBM will maintain its focus on expense discipline (its expense to revenue ratio is 46% compared with the peer average of 52%) as revenue growth is pressured. Beyond 2020, we anticipate operating income will remain lower than the 2019 level at least through 2022, given we expect market interest rates will remain relatively low.

The bank's adjusted common equity represents 100% of its total adjusted capital, in line with peers'. We estimate that the bank will maintain a three-year average earnings buffer of 1.9% of risk-adjusted assets, indicating a strong earnings cushion based on its standard over-the-cycle loss assumptions.

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, 2019, HBBM's Common Equity Tier 1 (CET 1) and total capital ratios were 23.8% and 23.9%, respectively. We believe that the bank's CET 1 ratio could rise in 2020 from 2019 should RWA reduce.

Chart 2



RAC--Risk adjusted capital. CET1--Common Equity Tier 1. Source: S&P Global Ratings.

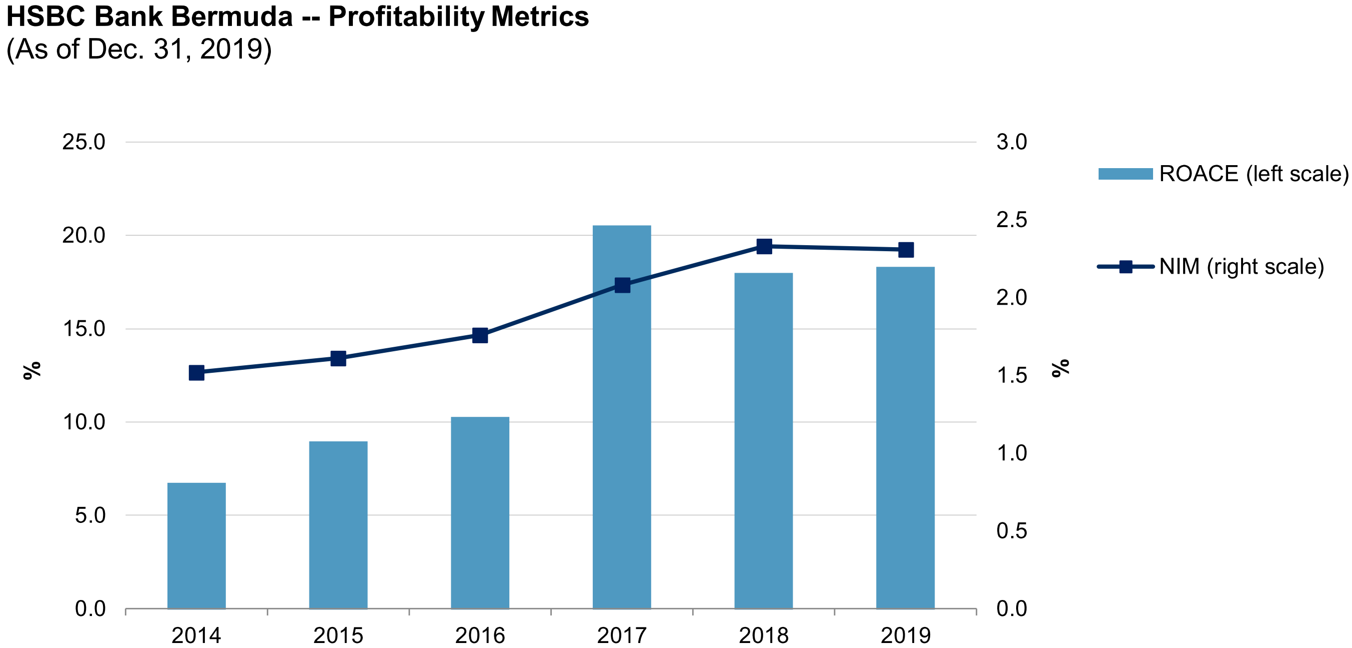
Table 3

HSBC Bank Bermuda Ltd. -- Capital And Earnings

	--Fiscal year-end Dec. 31--				
(%)	**2019**	**2018**	**2017**	**2016**	**2015**
S&P Global Ratings' RAC ratio before diversification	20.7	22.2	18.1	18.9	19.4
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	66.8	70.6	64.4	67.4	61.0
Fee income/operating revenues	19.7	19.2	16.8	20.1	24.4
Market-sensitive income/operating revenues	13.5	10.1	18.6	12.2	14.4
Cost to income ratio	46.0	51.2	46.0	58.9	57.6
Preprovision operating income/average assets	1.8	1.6	1.7	1.1	1.1
Core earnings/average managed assets	1.7	1.6	1.7	0.9	0.8

RAC--Risk adjusted capital.

Chart 3



ROACE--Return on average capital employed. NIM--Net interest margin. Source: S&P Global Ratings.

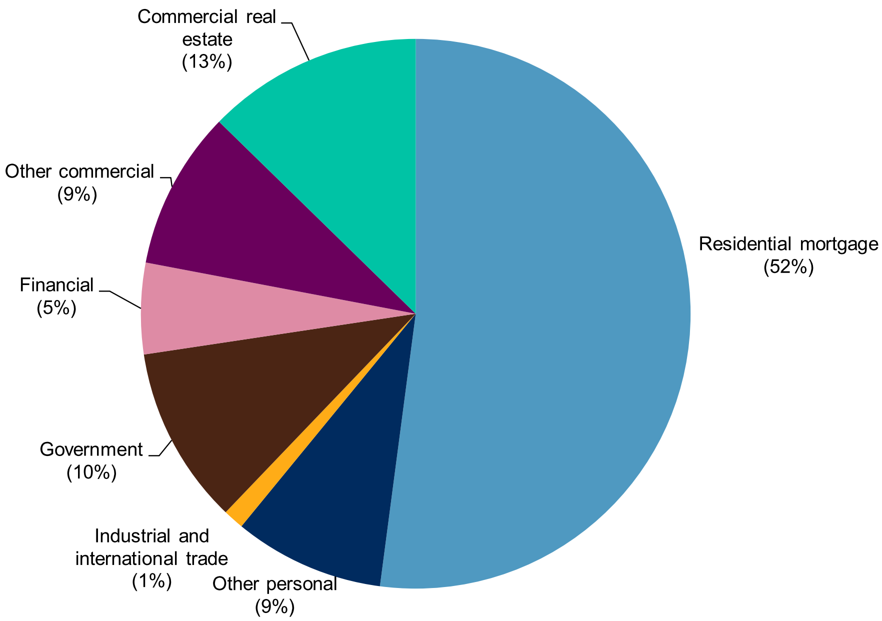
Risk position: Asset quality metrics that are significantly less favorable than peers' and under pressure from the pandemic

Our assessment of the bank's risk position considers asset quality that has performed substantially worse than its local peers' during the past few years, reflecting both Bermuda's weak economy and challenges in the bank's residential mortgage and commercial loan portfolios--including large, single-name exposures. Our assessment also takes into consideration risks emanating from the downturn and sharply higher unemployment, which we expect will negatively affect, in particular, sectors directly exposed to COVID-19. For 2020 and 2021, we expect higher NPAs in the commercial and retail loans. We expect net charge-offs (NCOs) to rise in 2020 and then stabilize in the latter half of 2021 as the economy begins to recover and clients return to market payment, which in our view, would decrease the likelihood for substantial increases in NCOs.

Loans represent a modest 27% of total assets. HBBM's gross NPAs to customer loans ratio was 15.8%. NCOs, which historically also have been higher than those of peers, were about 60 basis points (bps), up from 46 bps in 2018. Residential mortgages represent the largest component of loans at 52%. 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. That said, we believe some homeowners reliant on rental income from non-Bermudian workers (ownership of real estate below a price-threshold is restricted to Bermudians) could struggle from loss of employment and related income. Other consumer loans are modest (less than 9% of loans); however, because of their unsecured nature, loan losses could rise.

Chart 4

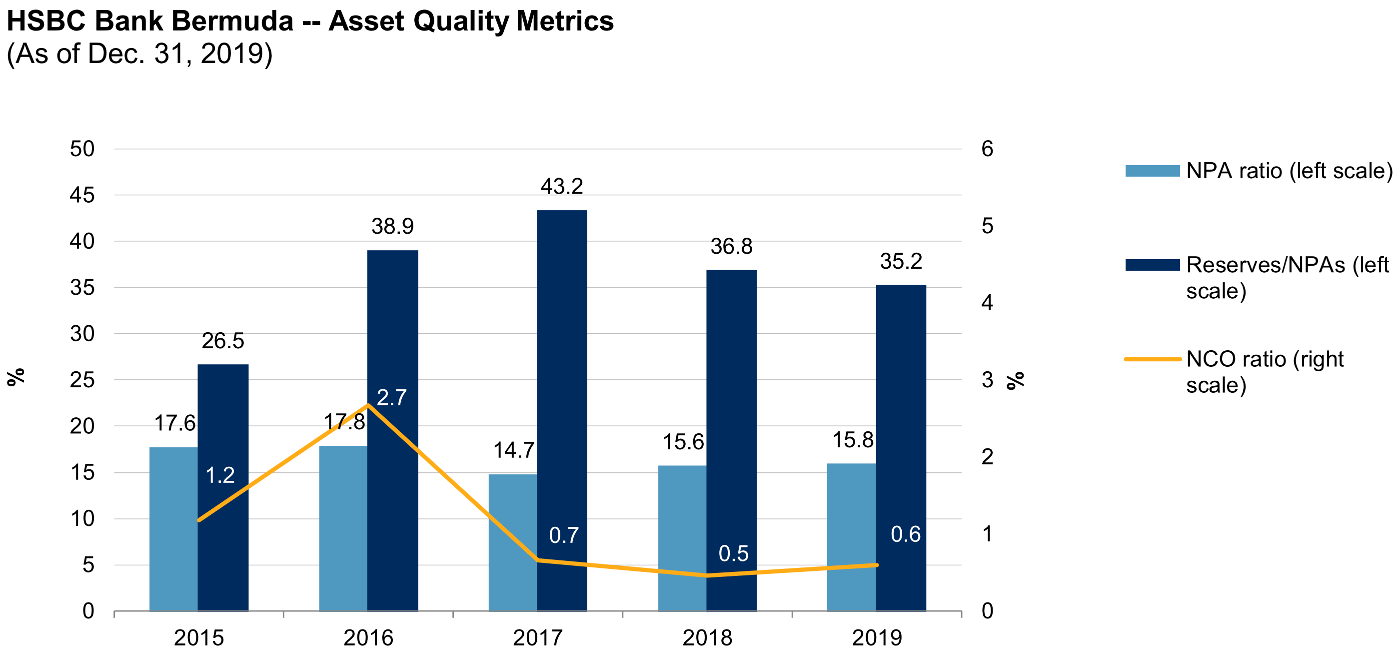
HSBC Bank Bermuda -- Loan Portfolio Breakdown
(As of Dec. 31, 2019)



Source: Company annual statement

The bank is exposed to a number of sectors that are being hit by the effects of the pandemic, and which represent a modest percentage of the business loan book, and which we view as manageable. Commercial real estate loans represented 13% of total loans. The exposure is significantly lower than that of most rated U.S. regional banks. The impact from the pandemic and sharply higher unemployment may exert further pressure on commercial tenants and related property values; however, we are not expecting outsize losses in this segment. We view the exposure as manageable, particularly because of the small size of the overall loan portfolio. Commercial loans (about 10%, which includes industrial and international trade and other commercial loans, of total loans) 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



NPA--Nonperforming assets. NCO--Net charge-offs. Source: S&P Global Ratings.

Table 4

HSBC Bank Bermuda Ltd. -- Risk Position

	--Fiscal year-end Dec. 31--				
(%)	**2019**	**2018**	**2017**	**2016**	**2015**
Growth in customer loans	(0.94)	(4.56)	(1.03)	(4.21)	(16.09)
Total managed assets/adjusted common equity (x)	10.91	10.16	11.93	11.79	11.95
New loan loss provisions/average customer loans	0.37	(0.11)	0.03	0.77	1.28
Net charge-offs/average customer loans	0.60	0.46	0.66	2.67	1.18
Gross nonperforming assets/customer loans + other real estate owned	15.83	15.61	14.70	17.78	17.64
Loan loss reserves/gross nonperforming assets	35.15	36.76	43.24	38.93	26.54

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

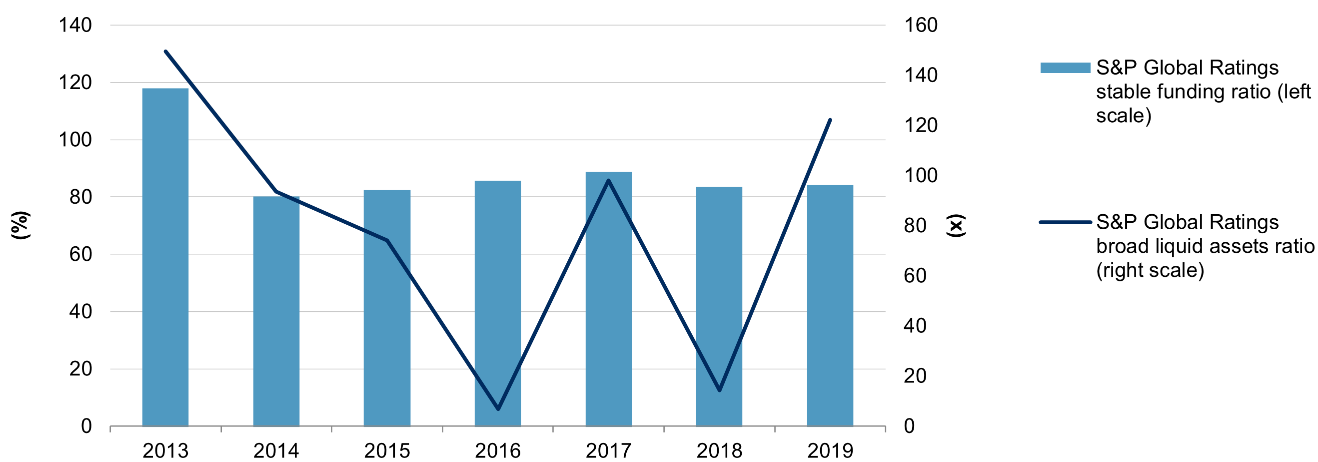
HBBM's funding profile, in our assessment, is average for a Bermudian bank, but its liquidity profile is strong (better than the average Bermudian bank). Historically, Bermudian banks have maintained more conservative funding and liquidity profiles than they otherwise might, we think because Bermuda 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).

The Bermudian government, unlike many governments in other jurisdictions, did not put in place funding and liquidity facility programs (earlier in the year) for the banks to access in order to help provide credit to customers in need during the pandemic. 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 should the Bermudian banks run into difficulties in keeping credit flowing.

HBBM's stable funding ratio (S&P Global Ratings' calculation) is about 84%, and less favorable than the peer average of 114%. Core deposits to the funding base, at 38%, 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 -- Funding And Liquidity Metrics
(As of Dec. 31, 2019)



Source: S&P Global Ratings.

HBBM maintains a large securities portfolio (about 46% 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 122x, which in our view, is very strong.

Table 5

HSBC Bank Bermuda Ltd.--Funding And Liquidity

	--Fiscal year-end Dec. 31--				
(%)	**2019**	**2018**	**2017**	**2016**	**2015**
Core deposits/funding base	38.3	38.4	38.1	33.7	34.5
Customer loans (net)/customer deposits	75.7	79.4	73.6	77.4	76.8
Long-term funding ratio	44.0	44.5	43.4	39.4	40.9

Table 5

HSBC Bank Bermuda Ltd.--Funding And Liquidity (cont.)					
	--Fiscal year-end Dec. 31--				
(%)	**2019**	**2018**	**2017**	**2016**	**2015**
Stable funding ratio	83.8	83.1	88.5	85.2	82.0
Short-term wholesale funding/funding base	0.4	3.7	0.6	9.0	1.0
Broad liquid assets/short-term wholesale funding (x)	122.2	14.1	97.9	6.8	74.0
Net broad liquid assets/short-term customer deposits	174.5	160.0	186.9	191.6	268.1
Short-term wholesale funding/total wholesale funding	0.7	6.1	0.9	13.5	1.5

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.

Additional rating factors:None

No additional factors support this rating.

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, 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: 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: 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 November 30, 2020)*

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
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.