

Research Update:

HSBC Bank Bermuda Ltd. Ratings Lowered To 'A+/A-1' From 'AA-/A-1+'; Outlook Is Stable

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Overview

- Following a full review on HSBC Bank Bermuda Ltd. (HSBC BB) under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we lowered our ratings on HSBC BB to 'A+/A-1' from 'AA-/A-1+' on Nov. 29, 2011. The outlook on the long-term rating is stable.
- Our ratings on HSBC BB reflect our view of the bank as a highly strategic operating subsidiary of HSBC Holdings PLC (HSBC; A+/Stable/A-1).
- Under our group methodology criteria, our 'A+' rating on HSBC BB is one notch below the 'AA-' ratings on the group's core operating entities.
- Our stand-alone credit profile (SACP) on HSBC BB is 'a-', which reflects our view of its adequate business position, very strong capital and earnings, moderate risk position, average funding, and adequate liquidity compared with the average bank in Bermuda.

Rating Action

As we previously announced, on Nov. 29, 2011, Standard & Poor's Ratings Services lowered its long- and short-term issuer ratings on HSBC BB to 'A+/A-1' from 'AA-/A-1+'. The SACP is 'a-'. The outlook on the long-term rating is stable, reflecting the outlook on the parent, HSBC.

Rationale

The downgrade of HSBC BB resulted from the downgrade of HSBC BB's parent company, U.K.-incorporated bank holding company HSBC, under our revised bank criteria. Under our group methodology criteria, we view HSBC BB as having high strategic importance to its parent company. The 'A+' rating on HSBC BB is one notch below the 'AA-' ratings on the group's core operating entities, as opposed to the group's SACP of 'a+', because we believe it is likely that extraordinary U.K. sovereign support provided to HSBC would extend to HSBC BB.

Standard & Poor's assessment of HSBC BB's SACP is based on our view of its "adequate" business position, "very strong" capital and earnings, "average" funding, and "adequate" liquidity (as our criteria define these terms) compared with other banks in Bermuda. Our view of its "moderate" risk position, which results from the significant deterioration in its loan performance in recent years; our expectations for further weakening in 2012; and its large concentrated commercial loan exposures, including exposures in the hospitality sector, partially offsets the strengths.

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA)

economic and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The 'bbb+' anchor for HSBC BB draws on our view of Bermuda as a small economy that is highly dependent on the financial services, real estate, and tourism industries. The local economy's growth is materially slowing down, in our assessment, in part because of the departure of several thousand expatriates in recent years from the island as well as lower real estate sales. With regard to industry risk, a high and stable share of core customer deposits and a very high concentration of banking assets underpin the Bermuda banking industry.

We believe that HSBC BB, a wholly owned subsidiary of HSBC, has an "adequate" business position in Bermuda relative to the average bank there. HSBC BB is the largest bank in Bermuda, with nearly \$12.9 billion in total credit exposures as of June 30, 2011, according to its interim Pillar 3 disclosures. Established in 1889 and incorporated in 1891, HSBC BB provides retail and corporate banking, investment, trust, custody, and insurance services. We estimate that HSBC BB has a deposit market share of roughly 45% in Bermuda--slightly more than its nearest competitor. We believe that HSBC BB's management is focused on its core businesses and regions, given its conservative views regarding potential expansion opportunities. We view this conservatism favorably in our rating assessment because of the limited opportunities for loan growth within the bank's local market and its excess of customer deposits relative to loans.

Capital and earnings are "very strong," in our opinion. We expect the risk-adjusted capital (RAC) ratio to decline over the next few years given our forecast of strong corporate loan growth and a very high dividend payout ratio. Specifically, we project that HSBC BB's RAC ratio before adjustments will decline to about 24% by the end of 2012. This projected RAC ratio is one of the highest of the banks we rate globally. The bank's quality of capital is also high given that the bank has no hybrid issues outstanding. Although we expect loan performance to weaken further and loan loss provisions to rise, we expect the bank to remain solidly profitable as a result of a healthy net interest margin (NIM), a rebound in fee-based revenues, and a continued focus on cost management.

HSBC BB's risk position is "moderate" in our assessment. We believe that HSBC BB's loan performance has weakened significantly in recent quarters because of a weaker economy in Bermuda, challenges within its commercial loan portfolio, and increasing pressure on residential home prices and rental income. The bank's various loan exposures, notably in the commercial loan portfolio including large, single-name exposures to the hospitality sector, and a weaker local economic environment may have also played a part. In addition, we expect further deterioration in loan performance in 2012 largely as a result of the bank's exposure to the hospitality sector and local commercial businesses. Loan loss reserves are weak, in our opinion, even though net charge-offs have been extremely low historically.

HSBC BB's funding is "average" and liquidity is "adequate," in our opinion, compared with the average bank in Bermuda. The bank's large deposit base

benefits from its captive insurance clients--which provide a relatively stable and inexpensive source of funding for the bank. Customer deposits easily exceed loan balances, and the bank invests these excess deposits primarily in financial instruments and loans to banks. However, the majority of the bank's customer deposits have very short maturities, typically one month or less, in part as a result of corporate clients depositing working capital with the bank. We view this as a minor concern given that deposits have been relatively stable historically in part due to the strength of the HSBC franchise.

Outlook

We expect that HSBC BB's loan performance could weaken further in 2012 and that its net earnings could decline somewhat. Despite this, the outlook on HSBC BB is stable, which is consistent with the outlook on its parent company, HSBC. We expect that our ratings on HSBC BB will move in line with our ratings on HSBC.

Separately, we may lower our rating on HSBC BB if we no longer consider the bank to be highly strategic to HSBC under our group methodology criteria. Conversely, we could raise the rating on HSBC BB if we reclassify it as "core" to HSBC under our group rating methodology. We consider this as unlikely, given our expectation that HSBC BB is likely to remain relatively small in a group context and we do not consider it to be as "fully integrated" into the group, as defined in our criteria, as certain other subsidiaries.

Ratings Score Snapshot

Issuer Credit Rating	A+/Stable/A-1
Bank Holding Company Rating	A+/Stable/A-1
SACP	a-
Anchor	bbb+
Business Position	Adequate (0)
Capital and Earnings	Very Strong (+2)
Risk Position	Moderate (-1)
Funding and Liquidity	Average and adequate (0)
Support	+2
GRE Support	0
Group Support	+2
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

- Research Update: HSBC And Core Operating Subsidiaries Ratings Lowered On Bank Criteria Change; Outlook Stable, Nov. 29, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology For Banks, Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Nov. 1, 2011
- HSBC Bank Bermuda Ltd., Oct. 20, 2011
- Industry Report Card: Large U.S. Regional and Trust Banks Posted Better Second-Quarter Results; Outlooks On Most Are Stable, Aug. 18, 2011
- Commercial Real Estate Remains A Problem For U.S. Banks, But The Worst Could Be Over, March 28, 2011
- Criteria | Financial Institutions | Banks: Bank Capital Methodology And Assumptions, Dec. 6, 2010

Ratings List

Downgraded; Outlook Action

	To	From
HSBC Bank Bermuda Ltd. Counterparty Credit Rating	A+/Stable/A-1	AA-/Negative/A-1+

Downgraded

	To	From
HSBC Bank USA N.A. Certificate Of Deposit	AA-/A-1+	AA/A-1+
HSBC USA Inc. Counterparty Credit Rating	A+/Stable/A-1	AA-/Stable/A-1+
Certificate Of Deposit	A+/A-1	AA-/A-1+

HSBC Bank Canada

Senior Unsecured	AA-	AA
Subordinated	A+	AA-
Preferred Stock	A-	A
Preference Stock	A-	A
Certificate Of Deposit	AA-/A-1+	AA/A-1+

HSBC Bank USA N.A.

Senior Unsecured	AA-	AA
Subordinated	A+	AA-

HSBC Canada Asset Trust

Preferred Stock	A-	A
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HSBC USA Capital Trust I

Preferred Stock	BBB+	A-
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HSBC USA Capital Trust II Preferred Stock	BBB+	A-
HSBC USA Inc. Senior Unsecured Subordinated Preferred Stock Commercial Paper	A+ A BBB+ A-1	AA- A+ A- A-1+
Republic New York Capital I Preferred Stock	BBB+	A-
Republic New York Capital II Preferred Stock	BBB+	A-
Downgraded; Ratings Affirmed	To	From
HSBC Bank Canada HSBC Bank USA N.A. Counterparty Credit Rating	AA-/Stable/A-1+	AA/Stable/A-1+
HSBC Bank Canada Certificate Of Deposit	AA-/A-1+	AA/A-1+
Ratings Affirmed		
Banco HSBC Salvadoreno S.A. Counterparty Credit Rating Certificate Of Deposit Local Currency	BB-/Stable/B BB-	
HSBC Bank (Taiwan) Ltd. Counterparty Credit Rating Foreign Currency Local Currency	A+/Stable/A-1 twAAA/Stable/ twA-1+	
HSBC Mexico S.A. Counterparty Credit Rating Certificate Of Deposit	BBB/Stable/A-3 BBB	
HSBC Bank (Taiwan) Ltd. Senior Unsecured	twAAA	
HSBC Bank Canada Senior Unsecured Preferred Stock	A-1+ P-1 (Low)	

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Preference Stock	P-1(Low)
Certificate Of Deposit	A-1+
HSBC Canada Asset Trust Preferred Stock	P-1(Low)
HSBC Mexico S.A. Senior Unsecured	mxAAA

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