FitchRatings

RATING ACTION COMMENTARY

# Fitch Revises HSBC's Outlook to Negative on Coronavirus Outbreak

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Fitch Ratings - London - 01 Apr 2020: Fitch Ratings has revised HSBC Holdings plc's (HSBC) Outlook to Negative from Stable, while affirming the banking group's Long-Term Issuer Default Rating (IDR) at 'A+'. The action reflects the economic disruption driven by the coronavirus pandemic. A full list of rating actions is detailed below.

Unless noted below, the key rating drivers for HSBC and its subsidiaries are those outlined in our Rating Action Commentary published in December 2019 (Fitch Downgrades HSBC Holdings to 'A+').

Fitch expects global economic growth to decline sharply in 2020 and now estimates that the UK's GDP could fall by close to 4% in 2020 in its baseline forecast, followed by a sharp recovery in 2021. This expectation is based on containment measures being unwound in 2H20, with material downside risk to these economic forecasts.

The UK authorities have taken monetary and fiscal support measures for the private sector, which should be positive for the banking sector. Nonetheless, we expect asset quality to weaken compared with previous expectations and earnings to come under pressure from lower business volumes, higher loan impairment charges and pressure on net interest margins.

Fitch has also taken various actions on the Long-Term IDRs, Derivative Counterparty Ratings (DCRs), debt and deposit ratings of HSBC and various of its operating subsidiaries and removed them from Under Criteria Observation (UCO), where they were placed on 4 March 2020, following the publication of Fitch's new Bank Rating Criteria on 28 February 2020.

## RATING ACTIONS

| ENTITY/DEBT | RATING | | |
|---|---|---|---|
| HSBC Holdings plc | LT IDR | A+ | Affirmed |
| | ST IDR | F1+ | Affirmed |
| | Viability | a+ | Affirmed |
| | Support | 5 | Affirmed |
| | Support Floor | NF | Affirmed |
| • subordinated | LT | BBB | Affirmed |
| • senior unsecured | LT | A+ | Affirmed |

**VIEW ADDITIONAL RATING DETAILS**

## KEY RATING DRIVERS

HSBC enters this crisis from a relative position of strength, given its sound underlying earnings generation, strong asset quality, sound capitalisation above minimum regulatory requirements and strong funding and liquidity position. We believe that this gives HSBC moderate headroom to absorb some financial deterioration at its current ratings.

The Negative Outlook reflects our view that the economic and financial market fallout from the pandemic creates material downside risks to the main operating environments in which HSBC is active, and to its ability to execute on its strategy and planned restructuring in line with its targets. We also see an increased risk of deterioration in HSBC's asset quality, earnings and capitalisation as a result of the disruption, albeit from currently strong levels.

HSBC Bank plc's and HSBC UK Bank plc's Long-Term IDRs are now on Negative Outlook, in line with HSBC's Outlook as they are equalised with HSBC's. We have also upgraded the two subsidiaries' Long-Term IDRs and senior debt ratings to 'AA-' from 'A+' and HSBC Bank's DCR to 'AA-(dcr)' from 'A+(dcr)' and removed them from UCO. This reflects our expectation under our new criteria that external senior creditors will benefit from resolution funds ultimately raised by HSBC and which designed to protect HSBC Bank's and HSBC UK's senior creditors if the group fails.

HSBC Bank's and HSBC UK's Viability Ratings (VRs) are driven by our view that the ratings have sufficient headroom to absorb moderate deterioration in the banks' financial strength. However we see heightened risk to HSBC Bank's ability to execute on the bank's restructuring strategy, and to HSBC UK's ability to meet strategic growth targets, as well as to likely deterioration of the two banks' asset quality, earnings and capital strength.

Fitch has revised the Outlook on The Hongkong and Shanghai Banking Corporation Limited's (HKSB) IDR to Negative to reflect revenue and asset-quality challenges, as the environment weakens across many of the APAC markets in which the bank operates, and to mirror the Outlook revision of the ultimate parent, HSBC. Fitch has negative sector outlooks for most APAC banking systems due to impact from the pandemic, and we expect pressures at HKSB will be more acute outside of Hong Kong. HKSB's strong liquidity and capital buffers provide room to absorb asset-quality deterioration but the uncertain economic outlook in Asia can weigh on HKSB's performance.

Fitch has upgraded the Long-Term IDR and Deposit Rating of HSBC Trinkaus & Burkhardt AG (HSBC Germany) by one notch following the upgrade of the IDR of its parent, HSBC Bank, which underpins HSBC Germany's support-driven Long-Term IDR. This also reflects our view that the HSBC group's resolution plans are likely to result in HSBC Germany's external senior creditors being protected if the group fails. The revision of the Outlook to Negative is in line with that on HSBC Bank.

The Outlook revision of HSBC Latin America Holdings' Long-Term IDR is in line with the rating action on HSBC as the ratings are aligned with HSBC's to reflect our view of an extremely high probability that HSBC would support the subsidiary if needed.

The Tier 2 debt ratings of HSBC and HSBC Bank have been downgraded by one notch and removed from UCO to reflect the change in baseline notching for loss-severity to two notches (from one previously) from HSBC's VR, which acts as the anchor rating for both entities' debt, since these banks do not meet the specific conditions under our criteria for applying one notch.

HSBC's AT1 debt has been upgraded by one notch and removed from UCO to reflect a change in baseline notching to four notches (from the previous five) from the VR, reflecting a reduction in incremental non-performance risk relative to our previous assumptions. Our assessment is based on HSBC operating with a CET1 ratio that is comfortably above maximum distributable amount (MDA) thresholds and our expectation that this will continue.

## RATING SENSITIVITIES

Unless noted below, the rating sensitivities listed in each issuer's latest Rating Action Commentary continue to apply.

The most immediate downside risk to all HSBC banks' ratings is the economic and financial market fallout arising from the coronavirus outbreak as this represents a clear risk to our assessment of asset quality, earnings, capitalisation and funding.

We believe that HSBC's and subsidiaries' ratings have headroom to emerge with their ratings intact due to the relative strength of the group's company profile and execution record, as well as the group's and subsidiaries' financial strength. But this outcome will depend on the ultimate depth and duration of the coronavirus shock to the domestic and international economy. The ratings could be downgraded if the economic and financial market disruption arising from the pandemic is likely to reach a level that places sustained pressure on the banks' earnings and capitalisation.

HSBC has material credit exposures in emerging markets, which to date have been managed conservatively, concentrating on the stronger borrower segments in each country. The ratings would come under pressure if there are signs that credit quality in these markets deteriorates.

In the event HSBC is able to withstand rating pressure arising from the pandemic, the most likely trigger for an upgrade would be a successful execution of the restructuring and evidence that the group can generate strong returns that are commensurate with the risks taken, particularly if a larger proportion of business is carried out in more volatile regions.

The Long-Term IDRs of HSBC Bank, HSBC UK and HSBC Germany are sensitive to a change in Fitch's view regarding the probability of external senior creditors benefitting from resolution funds. This could result from e.g. a change in resolution legislation, a change in the role of the opcos for the group in a resolution, or a change in the amount of debt/equity buffers available to the opco in a resolution.

HSBC's and HSBC Bank's Tier 2 debt ratings, and HSBC's AT1 debt ratings, are sensitive to a change in HSBC's VR, which is the anchor rating for these debt classes. Tier 2 debt could upgraded if we assess the loss severity as lower, e.g. if HSBC's or HSBC Bank's buffers of Tier 2 and more junior debt increase to over 10% of risk-weighted assets (RWA). HSBC's AT1 ratings could also be downgraded if non-performance risk increases relative to the risk captured in the bank's VR, for example if capital buffers over regulatory requirements are eroded.

## BEST/WORST CASE RATING SCENARIO

Ratings of financial institutions issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings https://www.fitchratings.com/site/re/10111579.

## REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

## PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

The support-driven ratings of HSBC Bank, HSBC UK, HKSB, HSBC Germany and HSBC Latin America are driven by our view of the likelihood of support from HSBC.

## ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Additional information is available on www.fitchratings.com

## APPLICABLE CRITERIA

Bank Rating Criteria (pub. 28 Feb 2020) (including rating assumption sensitivity)

## ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

## ENDORSEMENT STATUS

| | |
|---|---|
| HSBC Bank plc | EU Issued |
| HSBC Holdings plc | EU Issued |
| HSBC Latin America Holdings (UK) Limited | EU Issued |
| HSBC Trinkaus & Burkhardt AG | EU Issued |
| HSBC UK Bank plc | EU Issued |
| The Hongkong and Shanghai Banking Corporation Limited | EU Endorsed |

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