



## Fitch Affirms Bermuda Commercial Bank at 'BB+'; Outlook Stable

Fitch Ratings-New York-22 May 2017: Fitch Ratings has affirmed the Long- and Short-Term Issuer Default Ratings (IDRs) of Bermuda Commercial Bank (BCB) at 'BB+/B'. The Rating Outlook remains Stable.

A complete list of ratings follows at the end of this release.

### KEY RATING DRIVERS

#### IDRs and VR

The affirmation reflects the company's good capital levels and high on-balance sheet liquidity that provides necessary offset for the bank's weak earnings profile, concentrated business model and deposit base.

Capital levels remain strong and provide a necessary buffer given the bank's concentrated business model that is focused on deriving returns primarily from asset based lending to consumers and small businesses, as well as investing in high yielding corporate bonds, equities and other risky financial instruments. As of fiscal year-end 2016 (FYE16), BCB had a Fitch Core Capital Ratio of 20.8% which is among the highest in Fitch's U.S. rated universe. Leverage is also low with a tangible common equity ratio of 14.8% at FYE16; a rating strength.

BCB reported a loss of \$6.6 million for FY16, primarily as a result of weak P&L in the externally managed investment portfolio. However, BCB has since engaged in efforts to improve the quality of the investment portfolio. At FYE16, roughly 55% of the portfolio consisted of high rated-government bonds and short-term high quality liquid assets (HQLA). This compares to 44% at FYE15. As a result, risk-based capital ratios remained stable over the year despite the loss reported in FY16. The rating affirmation incorporates this improvement in asset quality which, if maintained, is expected to improve earnings stability.

Until recently, BCB's credit risk originated primarily from the investment portfolio. As a result, loan impairments have historically been low. As of FYE16, BCB's impaired loans comprised 4.2% of total loans, with the vast majority of impaired loans held by the recently acquired Private and Commercial Finance Group (PCFG). PCFG is a consumer and small business finance company based in the U.K.

Fitch notes that over the last fiscal year, BCB has adjusted its business model to become more lending focused and less reliant on the investment portfolio for revenue. This has resulted in a decline of the level of interest income, dividends and potential gain-on-sale revenue. However, as the bank repositions the business and grows the PCFG loan portfolio, Fitch expects earnings to remain positive but low. Furthermore, Fitch expects earnings to follow an improving and more stable trend over the longer term given BCB's higher risk appetite.

BCB's on-balance sheet liquidity remains strong with cash and HQLA representing 42% of total assets as of FYE16, and a very low loan-to-deposit ratio of 47%. Nevertheless, Fitch believes BCB's strong balance sheet liquidity is necessary given BCB's corporate deposit concentrations that puts the bank at risk of large deposit outflows, especially during times of stress.

From a loss standpoint, loan performance at PCFG continues to improve and remains satisfactory on a risk-adjusted basis. The charge-off rate dropped to 1.2% in FY16, the lowest it has been in recent years. Fitch views PCFG's contribution to BCB's overall business as credit neutral given the greater stability it brings to earnings relative to the more volatile investment portfolio.

Furthermore, Fitch expects that asset quality will continue to improve as PCFG plans to originate higher quality loans following its recent grant of a banking license in the U.K. However, this is dependent on PCFG obtaining approval to begin taking deposits (expected mid-to-late 2017) which will drive cost of funds lower.

### SUPPORT RATING AND SUPPORT RATING FLOOR

BCB's Support Rating of '5' and Support Rating Floor of 'NF' reflect our view that BCB is not systemically important in the local Bermuda market and, therefore, Fitch believes the probability of support is unlikely. IDRs and VRs do not incorporate any support for BCB.

### RATING SENSITIVITIES

#### IDRs and VR

BCB's ratings are firmly situated at current levels and ratings upside potential is currently limited.

Over the longer term, BCB could garner positive ratings momentum should it significantly improve its deposit composition and franchise, stabilize and diversify earnings and maintain solid asset quality in both its loan and investment portfolios.

Negative ratings pressure could develop should the bank continue to report a net loss or the bank is unable to achieve earnings improvement and stability.

Additionally, should BCB manage capital aggressively or if the quality of the investment or loan portfolio weakens materially, negative ratings momentum could also develop. Additionally, material losses associated with derivative positions will also cause negative ratings pressure.

Fitch has affirmed the following ratings:

Bermuda Commercial Bank

--Long-Term IDR at 'BB+'; Outlook Stable;

--Short-Term IDR at 'B';

--Viability Rating at 'bb+'

--Support Rating at '5';

--Support Floor at 'NF'.

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#### **Applicable Criteria**

Global Bank Rating Criteria (pub. 25 Nov 2016) (<https://www.fitchratings.com/site/re/891051>)

#### **Additional Disclosures**

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