

## CREDIT OPINION

17 October 2019

Update

✓ Rate this Research

### RATINGS

#### Banco BOCOM BBM S.A.

Domicile	Rio de Janeiro, Rio de Janeiro, Brazil
Long Term CRR	Ba1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Withdrawn
Type	Senior Unsecured - Dom Curr
Outlook	Rating(s) WithDrawn
Long Term Deposit	Ba3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Banco BOCOM BBM S.A.

### Update to credit analysis

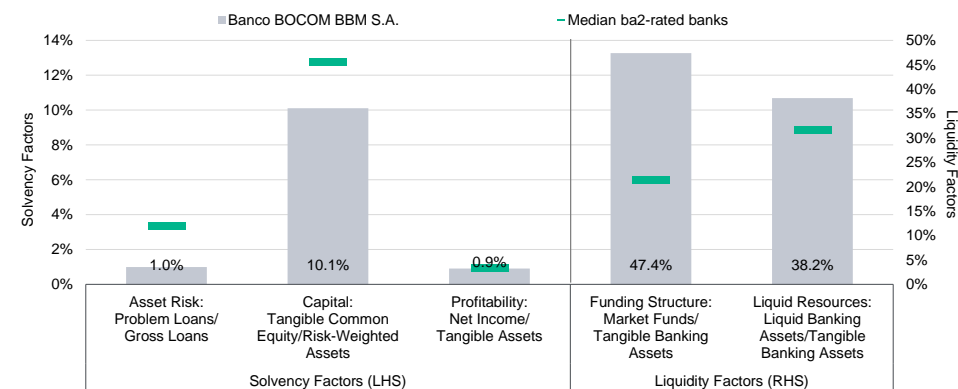
#### Summary

[Banco BOCOM BBM S.A.](#)'s (BOCOM BBM) Baseline Credit Assessment (BCA) of ba2 incorporates the bank's good asset quality metrics, which results in a track record of low loan losses. However, the bank continues to report high borrower concentration relative to tangible common equity (TCE) because of the high participation of large companies in the bank's loan portfolio, which increases asset risk. The bank offsets such risk by focusing on customers with better risk profiles. The ba2 BCA also reflects profitability metrics that have benefited from larger loan volume and margins. In addition, the BCA also incorporates a capital position that will likely accommodate at strong levels, despite the bank's increasing leverage, and a funding structure that relies on market funds and also has moderate participation of resources provided by its parent, [Bank of Communications Co., Ltd.](#) (BoCom, A2 stable, baa3).

BOCOM BBM's long-term local-currency deposit rating of Ba1 derive from the Adjusted BCA of ba1, which incorporates a one-notch uplift from the BCA of ba2. The uplift reflects the high level of affiliate support, given BoCom's majority ownership stake of 80% (acquired in November 2016) and the strategic importance of the subsidiary. We also assign a Ba3 long-term foreign-currency deposit rating, which is constrained by the Brazilian country ceiling.

Exhibit 1

#### Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

## Credit strengths

- » The bank's effective credit risk management mitigates asset risk, while the improved risk profile of its loan book offsets higher borrower concentration relative to TCE.
- » Capital position remains strong, despite increased leverage.

## Credit challenges

- » High reliance on market funding, partially offset by sizable liquid assets.
- » Profitability subject to volatility, given the intrinsic borrower concentration in its loan portfolio. However, profits will likely benefit from rising loan volume.

## Outlook

All the ratings have a stable outlook. BOCOM BBM's Ba1 local-currency deposit rating is one notch higher than [Brazil's](#) sovereign bond rating. The outlook on the local-currency deposit rating reflects the stable outlook on the parent's ratings.

## Factors that could lead to an upgrade

At the moment, there is no upward pressure on BOCOM BBM's BCA of ba2 because the assessment is constrained by Brazil's sovereign bond rating of Ba2. An upgrade of Brazil's bond rating would likely exert upward pressure on the bank's BCA. A multi-notch upgrade of BoCom's BCA could lead to an upgrade of BOCOM BBM's local currency deposit rating.

## Factors that could lead to a downgrade

BOCOM BBM's ratings could be downgraded in case of a higher-than-expected deterioration in its capital position and asset risk profile following the new strategic focus and eventual higher balance-sheet leverage. In addition, a multi-notch downgrade of BoCom's BCA could lead to a downgrade of BOCOM BBM's deposit ratings.

## Key indicators

Exhibit 2

### Banco BOCOM BBM S.A. (Consolidated Financials) [1]

	06-19 <sup>2</sup>	12-18 <sup>2</sup>	12-17 <sup>2</sup>	12-16 <sup>2</sup>	12-15 <sup>2</sup>	CAGR/Avg. <sup>3</sup>
Total Assets (BRL Billion)	6.9	6.7	5.1	4.1	3.8	18.5 <sup>4</sup>
Total Assets (USD Billion)	1.8	1.7	1.5	1.3	1.0	19.5 <sup>4</sup>
Tangible Common Equity (BRL Billion)	0.6	0.6	0.6	0.6	0.6	1.2 <sup>4</sup>
Tangible Common Equity (USD Billion)	0.2	0.2	0.2	0.2	0.1	2.2 <sup>4</sup>
Problem Loans / Gross Loans (%)	0.8	0.2	1.9	1.1	0.9	1.0 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	10.1	12.3	12.4	14.1	13.3	12.4 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	5.1	1.2	8.9	3.0	2.1	4.0 <sup>5</sup>
Net Interest Margin (%)	3.7	4.2	4.3	3.6	3.4	3.8 <sup>5</sup>
PPI / Average RWA (%)	3.2	3.2	2.3	1.5	1.2	2.3 <sup>6</sup>
Net Income / Tangible Assets (%)	1.1	1.0	0.8	0.8	1.1	1.0 <sup>5</sup>
Cost / Income Ratio (%)	46.9	47.5	56.4	60.3	66.7	55.6 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	42.2	47.4	41.5	41.2	58.1	46.1 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	34.6	38.2	35.1	50.7	58.1	43.3 <sup>5</sup>
Gross Loans / Due to Customers (%)	127.6	126.9	129.1	99.4	143.8	125.4 <sup>5</sup>

[1]All figures and ratios are adjusted using Moody's standard adjustments. [2]Basel III - fully-loaded or transitional phase-in; LOCAL GAAP. [3]May include rounding differences due to scale of reported amounts. [4]Compound Annual Growth Rate (%) based on time period presented for the latest accounting regime. [5]Simple average of periods presented for the latest accounting regime. [6]Simple average of Basel III periods presented.

Source: Moody's Investors Service; Company Filings

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## Profile

Founded in 1858, BOCOM BBM started operations as Banco da Bahia, dedicated to retail and middle-market lending activities. In 1998, the bank's commercial arm merged with the investment bank Banco da Bahia Investimentos and formed a multiple banking structure, changing its name to Banco BBM S.A. In May 2015, Bank of Communications Co., Ltd. announced the acquisition of an 80% stake in the bank. The remaining 20% of the bank is owned by the former shareholders, mainly comprising the Mariani family.

Originally, BOCOM BBM's core business was wholesale commercial lending, proprietary trading activities and asset management. In 2003, the bank began to diversify its earnings base and expanded its operations into commercial lending to upper-middle-market companies, mainly in the form of working capital loans in local currency or trade-finance-related credit operations. As of today, the bank's corporate lending is largely secured by guarantees or contractual cash flow.

## Detailed credit considerations

### Higher borrower concentration will be offset by the improved risk profiles of customers

BOCOM BBM's Asset Risk score of baa3 reflects its track record of low problem loan ratios, which reflects the bank's prudent underwriting standards. The score also incorporates the bank's expanded focus on large corporations, which also leads to an intrinsic increase in borrower concentration. However, the bank mitigates credit risk by focusing on customers with robust risk profiles.

The acquisition of Banco BBM's operations by BoCom contributed to loan growth, particularly as a result of access to new borrowers, including large corporate clients and Chinese companies. Because the bank targets large corporations, its consistently strong asset quality may improve further, although the risk of increasing loan concentration may increase volatility in asset risk and earnings.

In June 2019, BOCOM BBM's total credit exposure was BRL5.49 billion, which represented 32% annual growth. The rise in lending was driven by the bank's efforts to increase credit leverage. At the same time, the bank's problem loan ratio dropped to 0.8% from 1.1% a year earlier. Reserve coverage of 0.8% of total credit exposure reflects the bank's low levels of problem loans.

Strong credit underwriting policies and entrenched controls have protected BOCOM BBM from credit and market risk disruptions through economic cycles. Historically, the bank has reported low problem loan ratios, supported by a rigid and recognized risk management architecture, and control parameters that have proved capable of supporting the bank's risk appetite, as well as collateralization of the portfolio in previous bad cycles.

At the same time, the bank's portfolio is relatively concentrated, with the 20 largest borrowers representing 336% of TCE and 37.2% of its total credit exposure in June 2019.

### Capital has declined with loan growth, but remains at a moderate level

BOCOM BBM's Capital score of ba3 takes into consideration the current level of its capital ratio and the capital consumption arising from the ongoing expansion of its lending activity.

We expect the bank to maintain moderate, but solid, capital metrics, at the same level as the current ratio of TCE to risk-weighted assets (RWAs) of 10.1%. We have a more conservative view on capitalization and adjust our TCE/RWA ratio by assigning a 100% weight for government securities and limiting to 10% the amount of deferred tax assets that can contribute to TCE.

The regulatory Common Equity Tier 1 capital ratio declined to 12.1% from 14.4% in the last twelve months ended in June 2019, but it still has a comfortable level of 510 bps above the minimum regulatory CET1. In January 2019, the bank issued a BRL200 million perpetual subordinated local debt (letra financeira subordinada) that helped to rise its regulatory Tier 1 capital ratio to 16.3% in June 2019 from 14.4% one year prior.

### Profitability will continue to benefit from an increase in lending and larger scale

BOCOM BBM's Profitability score of ba1 incorporates the potential incremental pressures on margins from low interest rate environment in Brazil, which are likely to be counterbalanced by higher volume of lending operations and higher gains of scale. In June 2019, the ratio of net income to tangible assets decreased to 1.1% from 1.4% a year earlier.

Profitability is likely to increase because of the greater scale that the bank will gain as it grows its balance-sheet size while maintaining almost the same administrative infrastructure. However, the improvement in profitability may be partially offset by lower yields from lending to newly targeted companies and by the higher risk of credit cost fluctuation from increased borrower concentration.

### **Defensive liquidity management mitigates high reliance on market funds**

The Combined Liquidity score of ba3 reflects the bank's high reliance on market funding. However, it also incorporates the large amount of liquid assets held by the bank and a favorable tenor gap in its balance sheet.

We expect BOCOM BBM's reliance on market funds to remain high, although the bank will likely have access to a wider pool of investors. In addition, it will likely benefit from funding facilities provided by the parent. These factors will support the bank's expanded strategic focus, enabling it to appropriately manage its liquidity in response to a possible extension of its assets duration.

BOCOM BBM has been managing tenor gaps and costs by issuing local-currency debt instruments (letras financeiras, with a minimum two-year tenor) and other deposit-like instruments, such as agribusiness-linked notes and residential mortgage-backed securities. BOCOM BBM has also taken advantage of the increased demand for fixed-income bonds, which, in some cases, have lower costs because banks are not required to place reserve requirements at the central bank. Total deposits and deposit-like instruments accounted for BRL3.3 billion in June 2019, representing about 57% of the funding mix. BOCOM BBM has a relatively low reliance on foreign-currency lines, which represented 31% of total funding in June 2019. This exposure will likely increase as the bank gains access to a wider pool of investors.

BOCOM BBM's large position in government securities works as a buffer in times of stress, together with a conservative cash policy, which is comfortable and meets the bank's 180-day horizon obligations. BOCOM BBM also adopts strong rules that prioritize the duration of deposits, which allow the bank to work with no liquidity gap, unlike most of its peers.

### **BOCOM BBM's rating is supported by the Moderate- Macro Profile of Brazil**

The Moderate- Macro Profile of Brazil reflects the large scale and diversification of the country's economy, its strong international reserves and the improved effectiveness of its monetary policy. However, the economic rebound that started in 2017 after two years of economic contraction has been low, reflecting the political uncertainties surrounding policy continuity beyond 2019. We expect economic growth to remain moderate in 2019, which will support modest lending growth in the next 12 months because of low interest rates and inflation, which improve borrowers' repayment capacity. Asset quality is likely to remain stable, with no pressure on funding needs. The slowdown in government-owned banks' lending has reduced market distortions.

### **ESG Considerations**

BOCOM BBM's exposure to Environmental risks is low, consistent with our general assessment for the global banking sector. See our [Environmental risk heatmaps](#) for further information.

Overall, we consider banks to face moderate social risks. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizeable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage due to product mis-selling or other types of misconduct is a further social risk. Social trends are also relevant in a number of areas, such as shifting customer preferences towards digital banking services increasing information technology cost, aging population concerns in several countries impacting demand for financial services or socially driven policy agendas that may translate into regulation that affects banks' revenue base.

Governance is highly relevant for BOCOM BBM, as it is to all players in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit a bank's credit profile. Governance risks are largely internal rather than externally driven, and for BOCOM BBM we do not have any particular governance concerns. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

## Support and structural considerations

### Affiliate support

We believe there is a high probability of affiliate support for BOCOM BBM from its controlling bank, BoCom, given its majority ownership stake and the strategic importance that the Brazilian subsidiary may have for its parent bank. BoCom is expected to appoint executives to certain key positions at the bank and will closely engage in the subsidiary's strategic decision making process, including BOCOM BBM's support to the operations of Chinese companies in Brazil. Therefore, BOCOM BBM's Adjusted BCA of ba1 incorporates a one-notch uplift from its ba2 BCA.

### Government support

BOCOM BBM's local-currency deposit rating of Ba1 derive from its ba1 Adjusted BCA and do not benefit from government support uplift, given the bank's modest market share of domestic deposits.

### Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss suffered in the event of default, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

#### **BOCOM BBM's CR Assessment is positioned at Baa3(cr)/Prime-3(cr)**

The CR Assessment is one-notch above the bank's Adjusted BCA of ba1, and, therefore, above the deposit rating of the bank, reflecting our view that its probability of default is lower for the operating obligations than that for deposits. BOCOM BBM's CR Assessment does not benefit from government support because government support is not incorporated into the bank's deposit ratings.

### Counterparty Risk Ratings (CRRs)

Our CRRs are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

#### **BOCOM BBM's CRRs are positioned at Baa3/Prime-3**

BOCOM BBM's global local-currency CRRs are positioned at Baa3 and Prime-3, one notch above the bank's Adjusted BCA, reflecting the lower probability of default of CRR liabilities and our expectation of a normal level of loss given default. The long-term global foreign-currency CRR of Ba1 is at the same level as Brazil's foreign-currency debt ceiling, while the short-term global foreign-currency CRR is positioned at Not Prime.

### About Moody's Bank Scorecard

Our scorecard is designed to capture, express and explain in summary form our Rating Committee's judgment. When read in conjunction with our research, a fulsome presentation of our judgment is expressed. As a result, the output of our scorecard may materially differ from that suggested by raw data alone (though it has been calibrated to avoid the frequent need for strong divergence). The scorecard output and the individual scores are discussed in rating committees and may be adjusted up or down to reflect conditions specific to each rated entity.

## Rating methodology and scorecard factors

Exhibit 3

### Banco BOCOM BBM S.A.

#### MACRO FACTORS

WEIGHTED MACRO PROFILE	MODERATE	100%
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FACTOR	HISTORIC RATIO	INITIAL SCORE	EXPECTED TREND	ASSIGNED SCORE	KEY DRIVER #1	KEY DRIVER #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.0%	baa2	←→	baa3	Sector concentration	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	10.1%	ba3	←→	ba3	Expected trend	
Profitability						
Net Income / Tangible Assets	0.9%	ba2	←→	ba1	Expected trend	
Combined Solvency Score		ba1		ba1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	47.4%	b3	←→	b3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	38.2%	baa3	←→	baa3	Quality of liquid assets	
Combined Liquidity Score		ba3		ba3		
Financial Profile						
				ba2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Ba2		
Scorecard Calculated BCA range				ba1 - ba3		
Assigned BCA				ba2		
Affiliate Support notching				1		
Adjusted BCA				ba1		

INSTRUMENT CLASS	LOSS GIVEN FAILURE NOTCHING	ADDITIONAL NOTCHING	PRELIMINARY RATING ASSESSMENT	GOVERNMENT SUPPORT NOTCHING	LOCAL CURRENCY RATING	FOREIGN CURRENCY RATING
Counterparty Risk Rating	1	0	baa3	0	Baa3	Ba1
Counterparty Risk Assessment	1	0	baa3 (cr)	0	Baa3(cr)	
Deposits	0	0	ba1	0	Ba1	Ba3

[1]Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.

Source: Moody's Investors Service

## Ratings

Exhibit 4

Category	Moody's Rating
<b>BANCO BOCOM BBM S.A.</b>	
Outlook	Stable
Counterparty Risk Rating -Fgn Curr	Ba1/NP
Counterparty Risk Rating -Dom Curr	Baa3/P-3
Bank Deposits -Fgn Curr	Ba3/NP
Bank Deposits -Dom Curr	Ba1/NP
NSR Bank Deposits	Aaa.br/BR-1
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa3(cr)/P-3(cr)
<b>PARENT: BANK OF COMMUNICATIONS CO., LTD.</b>	
Outlook	Stable
Counterparty Risk Rating	A2/P-1
Bank Deposits	A2/P-1
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3
Counterparty Risk Assessment	A2(cr)/P-1(cr)
Pref. Stock Non-cumulative	Ba3 (hyb)

Source: Moody's Investors Service

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