

## CREDIT OPINION

17 April 2020

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Long Term Debt	Withdrawn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Outlook	Rating(s) WithDrawn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 / Ba1
Type	LT Bank Deposits - Fgn Curr / Dom 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

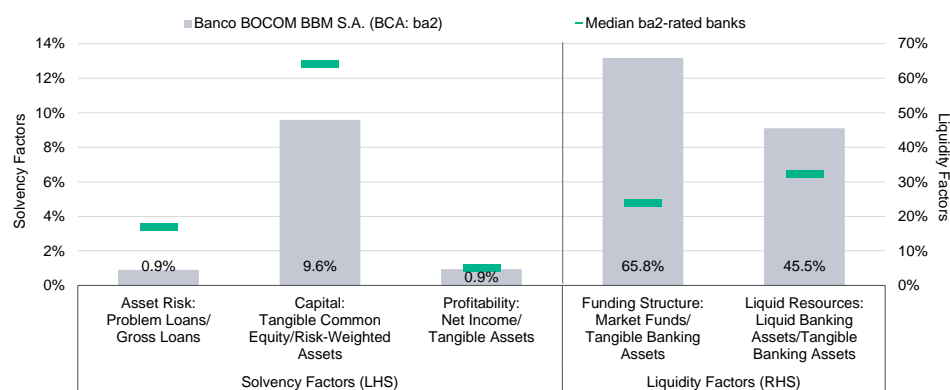
[Banco BOCOM BBM S.A.](#)'s (BOCOM BBM) Baseline Credit Assessment (BCA) of ba2 incorporates the bank's good asset quality metrics, which results in a track record of low loan losses. However, the bank also reports high borrower concentration relative to tangible common equity (TCE) because of the high participation of loans to 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 remained relatively steady in recent years, reflecting prudent loan underwriting and stringent control of operating expenses. In addition, the BCA is constrained by a funding structure that relies on market funds and has moderate participation of resources provided by its parent, [Bank of Communications Co., Ltd.](#) (BoCom, A2 stable, ba3).

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.

The global spread of the coronavirus is resulting in simultaneous supply and demand shocks. We expect these shocks to materially slow economic activity, particularly in the first half of this year. The full extent of the economic costs will be unclear for some time. We view that the coronavirus outbreak will likely have a negative effect on banks' asset quality and profitability around the world.

Exhibit 1

#### Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

## Credit strengths

- » The bank's conservative approach to credit risk management mitigates pressure on asset quality, while the improved risk profile of its loan book offsets higher borrower concentration relative to TCE.
- » Liquidity will increase as a consequence of slowdown in economic activity and reduction in loan origination.

## Credit challenges

- » High reliance on market funding, partially offset by sizable liquid assets.
- » Profitability likely to be modest because of weak economic activity, low loan growth and possible increase in credit cost.
- » Asset risk will likely weaken because of material deceleration in economic activity.

## 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.
- » In addition, a multi-notch downgrade of BoCom's BCA could lead to a downgrade of BOCOM BBM's deposit ratings.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on [www.moody's.com](http://www.moody's.com) for the most updated credit rating action information and rating history.

## Key indicators

Exhibit 2

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

	12-19 <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)	9.0	6.7	5.1	4.1	3.8	23.9 <sup>4</sup>
Total Assets (USD Billion)	2.2	1.7	1.5	1.3	1.0	23.4 <sup>4</sup>
Tangible Common Equity (BRL Billion)	0.6	0.6	0.6	0.6	0.6	2.2 <sup>4</sup>
Tangible Common Equity (USD Billion)	0.2	0.2	0.2	0.2	0.1	1.8 <sup>4</sup>
Problem Loans / Gross Loans (%)	0.6	0.2	1.9	1.1	0.9	0.9 <sup>5</sup>
Tangible Common Equity / Risk Weighted Assets (%)	9.6	12.3	12.4	14.1	13.3	12.3 <sup>6</sup>
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	3.5	1.2	8.9	3.0	2.1	3.7 <sup>5</sup>
Net Interest Margin (%)	3.7	4.2	4.3	3.6	3.4	3.8 <sup>5</sup>
PPI / Average RWA (%)	3.4	3.2	2.3	1.5	1.2	2.3 <sup>6</sup>
Net Income / Tangible Assets (%)	1.0	1.0	0.8	0.8	1.1	0.9 <sup>5</sup>
Cost / Income Ratio (%)	44.4	47.5	56.4	60.3	66.7	55.1 <sup>5</sup>
Market Funds / Tangible Banking Assets (%)	65.8	55.1	41.5	41.2	58.1	52.4 <sup>5</sup>
Liquid Banking Assets / Tangible Banking Assets (%)	45.5	38.2	35.1	50.7	58.1	45.5 <sup>5</sup>
Gross Loans / Due to Customers (%)	186.9	155.3	129.1	99.4	143.8	142.9 <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

## 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

### Asset quality metrics benefit from conservative credit underwriting standards

BOCOM BBM's Asset Risk score of baa3 reflects the bank's prudent underwriting standards and track record of low problem loan ratios. 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.

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.

However, the unexpected downturn in economic activity caused by the coronavirus outbreak will add negative pressure to BOCOM BBM's asset quality metrics in the next quarters. Despite that, the bank has adequate provisioning levels that can mitigate partially pressure on credit risk. Moreover, the low policy interest rate (Selic) and will likely aid borrowers' repayment capacity.

As of December 2019, BOCOM BBM's total credit exposure was BRL6.1 billion, which represented a 38% annual growth relative to one year prior. The rise in lending was driven by efforts to increase credit leverage. At the same time, the bank's problem loan ratio

increased slightly to 0.6%, from 0.2% a year earlier, driven by a growth in problem loans to BRL23.9 million, from BRL7.4 million one year prior. Despite that, loan loss provisions decreased to 0.3% of total gross loans as of December 2019, from 0.8% a year earlier.

At the same time, the bank's portfolio is relatively concentrated, with the 20 largest borrowers representing 324% of TCE and 35.5% of its total credit exposure as of December 2019.

#### **Capital will likely stabilize, reflecting lower profits and loan growth**

BOCOM BBM's Capital score of ba3 takes into consideration the current level of its capital ratio and the capital consumption that derived from the recent expansion of its loan book.

We expect the bank to maintain a stable capital metric, in line with the current Moody's preferred ratio of tangible common equity to risk-weighted assets (TCE/RWA) of 9.6%. 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.

BOCOM BBM's regulatory Common Equity Tier 1 (CET1) capital ratio increased to 11.4% in December 2019, from 14.5% one year prior, and was 565 bps above the minimum regulatory CET1 of 5.75%. This minimum will be in effect until March 2021 and it will increase gradually to 7.0% up to March 2022. In January 2019, the bank issued a BRL200 million perpetual subordinated local debt (letra financeira subordinada) that increased its regulatory Tier 1 capital ratio to 15.1% in December 2019, from 14.5% one year prior.

#### **Profitability will likely drop because of weak economy**

BOCOM BBM's Profitability score of ba1 incorporates an anticipated negative pressure on earnings generation as a result of a weak economic activity triggered by the lockdown to contain the coronavirus outbreak. Reduction in business activity has been sudden and widespread since March 2020, which has compressed companies' and households' income generation. As a consequence, we expect negative effect on bottom line results.

In December 2019, the bank reported net income of BRL 88.5 millions, or 39% higher than in the previous year. Also in 2019, the ratio of net income to tangible assets remained stable at 0.9% from a year earlier.

#### **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 maintain its efforts to access a broader variety of investors. In addition, the bank can also count on funding facilities provided its parent, which represented 34% of total funding in December 2019.

BOCOM BBM manages 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. In the past 12 months, BOCOM BBM also benefited from high demand for fixed-income bonds, which, in some cases, are less expensive to banks because they are not required to place reserve requirements at the central bank.

Total deposits, excluding interbank deposits, and deposit-like instruments accounted for BRL2.1 billion as of December 2019, representing about 33% of the funding mix. BOCOM BBM has a relatively low reliance on foreign currency lines, which represented 37% of total funding as of December 2019.

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**

Brazil's Macro Profile reflects the large size and diversified nature of the country's economy, and its more credible monetary policy, increasing commitment to addressing corruption and improving overall government effectiveness. However, Brazil's economic rebound has been weaker than expected, also reflecting the high uncertainty surrounding the economic growth in 2020 in face of the downturn triggered by the coronavirus outbreak.

Although government-owned banks continue to account for a substantial portion of total credit, their market share have been contracting since 2015, reducing market distortions created by their previous aggressive lending policies. The slowdown in economic recovery in 2020 further strains credit markets and the potential for banking lending. However, banks' funding needs will not be strained, given the high levels of liquidity, largely domestic customer deposits, and sustained low interest rates and low inflation will support borrowers' repayment capacity, leading to a stabilization in asset quality.

## 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. See our [Social risk heatmaps](#) for further information.

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 parent bank, BoCom, given its majority ownership stake and the strategic importance of the Brazilian subsidiary. 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%**

-

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	0.9%	baa1	↔	baa3	Sector concentration	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	9.6%	b1	↔	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	65.8%	caa2	↔	b3	Market funding quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	45.5%	baa2	↔	baa3	Quality of liquid assets	
Combined Liquidity Score		b1		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		
BCA Scorecard-indicated Outcome - 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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