

CREDIT OPINION

15 December 2020

Update

RATINGS

Banco BOCOM BBM S.A.

Domicile	Rio de Janeiro, Rio de Janeiro, Brazil
Long Term CRR	Baa3
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Long Term Debt	Withdrawn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Outlook	Rating(s) WithDrawn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	Ba1
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 following upgrade of foreign currency deposit rating

Summary

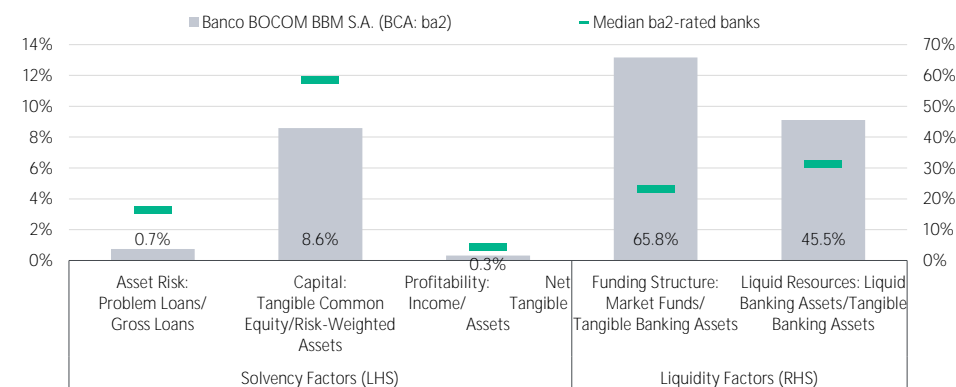
On 11 December 2020, [Banco BOCOM BBM S.A.](#)'s (BOCOM BBM) foreign currency deposit rating was upgraded to Ba1, from Ba3, following the upgrade of the foreign currency ceiling for [Brazil](#) to Baa2, announced on 7 December 2020. At the same date, Moody's upgraded BOCOM BBM's foreign currency counterparty risk ratings (CRRs) to Baa3 and Prime-3, long- and short-term, from Ba1 and Not-Prime. The rating upgrade followed the update of the "Local and Foreign Currency Country Ceilings Methodology" on 7 December 2020.

BOCOM BBM's Baseline Credit Assessment (BCA) of ba2 incorporates the bank's good asset quality metrics, which results in a track record of low loan losses. The ba2 BCA also reflects profitability metrics that remained relatively steady in 2018-19, reflecting prudent loan underwriting and stringent control of operating expenses. However, the constitution of additional provision expenses as a prudential measure against the COVID-19 pandemic contributed to a decline of profitability in the first half of 2020. The bank's BCA also reflects funding structure that comprised about 39% of resources provided by its parent, [Bank of Communications Co., Ltd.](#) (BoCom, A2 stable, baa3), as of June 2020, and a growing participation of time deposits from corporate clients.

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% and the strategic importance of the subsidiary.

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.
- » Robust liquidity as a consequence of slowdown in economic activity.

Credit challenges

- » Profitability likely to be modest because of weak economic activity and high volume of provision expenses.
- » Asset quality could weaken in 2021 as government stimulus measures expire, which could result in lower-than-expected economic recovery.

Rating outlook

All the ratings have a stable outlook. BOCOM BBM's Ba1 global deposit ratings are one notch higher than Brazil's sovereign bond rating. The outlook on the local and foreign currency deposit ratings 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.com for the most updated credit rating action information and rating history.

Key Indicators

Exhibit 2

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

	06-20 ²	12-19 ²	12-18 ²	12-17 ²	12-16 ²	CAGR/Avg. ³
Total Assets (BRL Billion)	9.2	9.0	6.7	5.1	4.1	25.8 ⁴
Total Assets (USD Billion)	1.7	2.2	1.7	1.5	1.3	8.4 ⁴
Tangible Common Equity (BRL Billion)	0.6	0.6	0.6	0.6	0.6	2.3 ⁴
Tangible Common Equity (USD Billion)	0.1	0.2	0.2	0.2	0.2	(11.9) ⁴
Problem Loans / Gross Loans (%)	0.3	0.6	0.2	1.9	1.1	0.8 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	8.6	9.6	12.3	12.4	14.1	11.4 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	1.5	3.5	1.2	8.9	3.0	3.6 ⁵
Net Interest Margin (%)	3.6	3.7	4.2	4.3	3.6	3.9 ⁵
PPI / Average RWA (%)	3.2	3.4	3.2	2.3	1.5	2.7 ⁶
Net Income / Tangible Assets (%)	0.3	1.0	1.0	0.8	0.8	0.8 ⁵
Cost / Income Ratio (%)	41.3	44.4	47.5	56.4	60.3	50.0 ⁵
Market Funds / Tangible Banking Assets (%)	61.7	65.8	55.1	41.5	41.2	53.1 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	45.1	45.5	38.2	35.1	50.7	42.9 ⁵
Gross Loans / Due to Customers (%)	160.3	186.9	155.3	129.1	99.4	146.2 ⁵

[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 because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime.

[6] Simple average of Basel III periods.

Sources: Moody's Investors Service and 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, Banco 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 has shown resilience to economic downturn

BOCOM BBM's Asset Risk score of baa3 reflects the bank's prudent underwriting standards and track record of low problem loan ratios. Despite the recent resilience of the bank's asset quality metrics to the weak economic environment associated with the COVID-19 pandemic in the past months, BOCOM BBM could report a growth in problem loans in 2021 if economic recovery is slower than expected after the end of government stimulus measures.

The score for Asset Risk also incorporates the bank's expanded focus on large corporations, which also leads to an intrinsic increase in borrower concentration. In June 2020, the 20 largest borrowers represented 316% of tangible common equity (TCE) and 38.9% of total credit exposure. Despite that, the bank mitigates credit risk by focusing on customers with robust risk profiles. In addition, strong credit underwriting policies and entrenched controls have protected BOCOM BBM from credit and market risk disruptions through economic cycles.

As of June 2020, BOCOM BBM's total credit exposure was BRL7.0 billion, compared with BRL5.5 billion one year prior (also including guarantees and corporate securities). The growth in lending was driven by efforts to increase credit leverage. At the same time, the bank's problem loan ratio decreased to 0.27%, from 0.80% a year earlier, driven by a decline in problem loans to BRL11 million, from BRL33 million in the previous year. Despite that, the bank increased loan loss provisions to 3.2% of total gross loans as of June 2020, from 0.5% a year earlier, mainly as a prudential measure in view of the COVID-19 pandemic.

Capital will likely stabilize despite lower profits and loan growth

BOCOM BBM's Capital score of ba3 takes into consideration our expectation that capitalization will likely remain fairly stable in the next 12 to 18 months because of the bank's diligent use of capital, despite negative pressure on profitability stemming from the weak economic environment.

As of June 2020, Moody's preferred ratio of tangible common equity to risk-weighted assets (TCE/RWA) for BOCOM BBM was 8.6%, lower than 10.1% in June 2019. The ratio drop reflected mainly an increase in liquid assets, particularly in the form of government securities, resulting in growth of RWAs. 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 went down to 10.6% in June 2020, from 12.1% one year prior. Despite that, the ratio was 483 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 supported the growth of its regulatory Tier 1 capital.

Profitability will likely drop because of weak economy

BOCOM BBM's Profitability score of ba1 incorporates negative pressure on earnings generation as a result of the weak economic activity associated with the COVID-19 pandemic. In addition, households' available income will likely shrink in early 2021 as government stimulus measures comes to an end in December 2020, which could result in decline of consumption and companies' sales. A reduction in sales could impair companies' ability to pay back loans and lead to an increase in provision expenses from banks.

As of June 2020, BOCOM BBM reported net income of BRL14.4 millions, 62% less than one year prior. One important driver for the decline in bottom-line results was loan loss provisions, which were BRL65 million in the first half of 2020, or more than 500% in the first half of 2019.

Because of the coronavirus pandemic the bank's loans loss provisions have increased to BRL65 million, more than 500% in the same period the previous year. Similarly other provisions increased to more than twice its size in the prior year to almost BRL1 million. Meanwhile, total operating expenses remained stable with a moderate growth of 1.8% to BRL78 million.

Net interest income was BRL157 million in June 2020, increasing 31.1% compared with one year prior. However, this increase in earnings was offset partially by a sizable growth in interest expenses, which went up almost 350% mostly as a result of the devaluation of the Brazilian real and its effect on the cost of funding sourced abroad. At the same time, non-interest income decreased 25.6% because of a drop in fees and commissions relative to one year earlier. As of June 2020, the ratio of net income to tangible assets decreased to 0.3% from 1.1% in June 2019.

Defensive liquidity management mitigates high participation of market funds

The Combined Liquidity score of ba3 reflects the large share of market funding in the bank's funding structure. 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 the participation of market funds (i.e. borrowings abroad and domestic banknotes) in BOCOM BBM's funding structure to remain high, although the bank will maintain its efforts to access a broader variety of investors. A sizable share of these market funds comprised funding facilities from its parent bank, which represented about 39% of total funding in June 2020.

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 (LCAs) and residential mortgage-backed securities (LCIs).

Total deposits, excluding interbank deposits, and deposit-like instruments accounted for BRL2.94 billion as of June 2020, representing about 40% of the funding mix. The participation of foreign currency lines in BOCOM BBM's total funding was roughly 47% as of June 2020.

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 prioritise 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 for Brazil incorporates the large-scale and highly diversified economy in a low-interest-rate and inflation environment, despite modest growth prospects. The Macro Profile also reflects Brazil's favorable credit conditions until the unexpected coronavirus pandemic, and the sustained accommodative monetary policy with low inflation and record low interest rates. We expect a moderate rebound in bank lending in 2021 and 2022, supported by economic recovery, which, however, will depend on the path of recovery. Private consumption and retail sales have been deeply affected by the pandemic since March 2020 and are expected to gradually recover in the medium term. However, labor and wage conditions will likely be the last to improve, which could affect demand for credit and banks' risk appetite in the next six to eight quarters.

Private banks are regaining market share as state-run banks focus on their respective policy mandates. Record low interest rates and low inflation will lead to a gradual increase in job creation, improving borrowers' repayment capacity and 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 and foreign 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 CRRs of Baa3 are one notch below Brazil's foreign currency ceiling for deposits and debt obligations.

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	0.7%	a3	↔	baa3	Sector concentration	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	8.6%	b2	↔	ba3	Expected trend	
Profitability						
Net Income / Tangible Assets	0.3%	b2	↔	ba1	Expected trend	
Combined Solvency Score		ba2		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	Baa3
Counterparty Risk Assessment	1	0	baa3 (cr)	0	Baa3(cr)	
Deposits	0	0	ba1	0	Ba1	Ba1

[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
BANCO BOCOM BBM S.A.	
Outlook	Stable
Counterparty Risk Rating	Baa3/P-3
Bank Deposits	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)
PARENT: BANK OF COMMUNICATIONS CO., LTD.	
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)

Source: Moody's Investors Service

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