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INVESTORS SERVICE

CREDIT OPINION
26 July 2023

Update

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**RATINGS**

**BRB-Banco de Brasilia S.A.**

| | |
|---|---|
| Domicile | Brasilia, Distrito Federal, Brazil |
| Long Term CRR | Ba3 |
| Type | LT Counterparty Risk Rating - Fgn Curr |
| Outlook | Not Assigned |
| Long Term Debt | Not Assigned |
| Long Term Deposit | B1 |
| 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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# BRB-Banco de Brasilia S.A.

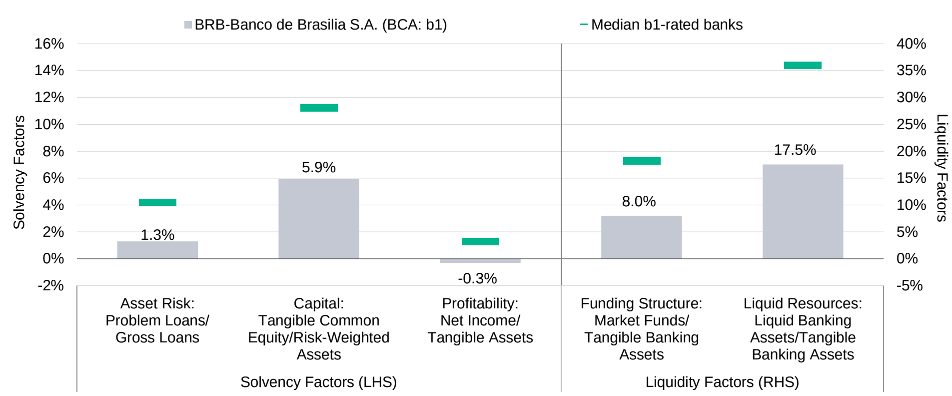
## Update following rating downgrade to B1

## Summary


The downgrade in BRB-Banco de Brasilia S.A. (BRB)'s BCA reflects the deterioration in the bank's capitalization and profitability metrics over the last two years, factors that will likely remain pressured by its expansion strategy beyond its traditional footprint. While this strategy will enhance business diversification and earnings capacity in the medium term, it also entails execution risks as the bank starts to operate in a highly competitive business environment with largest commercial banks. Over the past two years, BRB has grown its loan book by 101%, well above the industry's growth rate, which will likely put a strain on asset risks in the coming quarters. However, the b1 standalone credit profile also acknowledges the large share of low-risk payroll loans and mortgage financing in the bank's loan portfolio, 69% of total loans as of March 2023, from 66% in December 2020, which will help contain further deterioration in asset quality going forward.

The stable outlook recognizes BRB's well-established regional franchise with entrenched operations in the Federal District, supported by an ample access to low-cost and steady deposit base from public sector employees, government-related entities and judicial proceedings. The bank's low reliance on confidence-sensitive funding sources is a credit strength to BRB's financial profile.


Exhibit 1
**Rating scorecard - Key financial ratios**
**As of March 2023**




For the problem loan and profitability ratios, we review the latest three year-end ratios, as well as the most recent intra-year ratio, where applicable, and base our starting point ratio on the weaker of the average of this period and the latest figure. For the capital ratio, we use the latest figure. For the funding structure and liquid asset ratios, we use the latest year-end figures.
*Source: Moody's Financial Metrics*

## Credit strengths

» High participation of low-risk, collateralized operations in the loan portfolio mitigates credit risk

» Funding profile supported by ample access to low-cost retail deposits originated from a client base comprised mainly of public employees and government-related entities

## Credit challenges

» Concentration in the DF region increases risk of earnings becoming more volatile because of competition or economic downturn in the region

» Profitability is being pressured by squeezed interest margins whereas bank's expansion strategy is resulting in heightened operational and credit costs

» Capital metrics are modest compared with that of regional bank peers

» Whilst BRB has strengthened its corporate governance practices in the past five years, the bank is still prone to political interference

## Rating outlook

The stable outlook reflects our expectation that BRB's credit profile will remain consistent with its current ratings over the next 12-18 months.

## Factors that could lead to an upgrade

» BRB's standalone BCA could face upward pressure if the bank's business expansion strategy proves to be capable of generating sustainable earnings, ultimately restoring the bank's internal capital replenishment and loss-absorption capacity.

## Factors that could lead to a downgrade

» By contrast, BRB's ratings could be downgraded further if we see the continued credit growth into new business segments leading to a fundamental alteration of the bank's traditionally low-risk profile of its loan book. A sustained decline in profitability potentially resulting in additional capital erosion would be also negative to BRB's financial profile.

## Key Indicators

Exhibit 2
**BRB-Banco de Brasilia S.A. (Consolidated Financials) [1]**

| | 03-23[2] | 12-22[2] | 12-21[2] | 12-20[2] | 12-19[2] | CAGR/Avg.[3] |
|---|---|---|---|---|---|---|
| Total Assets (BRL Million) | 42,922.3 | 41,467.2 | 31,710.4 | 25,374.4 | 17,021.2 | 32.9[4] |
| Total Assets (USD Million) | 8,465.5 | 7,854.0 | 5,686.6 | 4,885.1 | 4,231.3 | 23.8[4] |
| Tangible Common Equity (BRL Million) | 1,824.1 | 1,792.8 | 2,126.6 | 1,774.3 | 1,352.6 | 9.6[4] |
| Tangible Common Equity (USD Million) | 359.8 | 339.6 | 381.4 | 341.6 | 336.3 | 2.1[4] |
| Problem Loans / Gross Loans (%) | 1.1 | 1.3 | 2.1 | 0.6 | 0.5 | 1.1[5] |
| Tangible Common Equity / Risk Weighted Assets (%) | 5.9 | 6.0 | 8.9 | 10.2 | 10.0 | 8.2[6] |
| Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%) | 14.7 | 16.6 | 15.1 | 4.2 | 3.3 | 10.8[5] |
| Net Interest Margin (%) | 5.8 | 6.8 | 9.4 | 12.9 | 14.3 | 9.8[5] |
| PPI / Average RWA (%) | 1.7 | 2.3 | 4.3 | 7.0 | 6.9 | 4.4[6] |
| Net Income / Tangible Assets (%) | -0.3 | 0.5 | 1.5 | 1.4 | 2.4 | 1.1[5] |
| Cost / Income Ratio (%) | 82.4 | 78.4 | 70.4 | 63.4 | 65.3 | 72.0[5] |
| Market Funds / Tangible Banking Assets (%) | 8.8 | 8.0 | 15.9 | 17.1 | 6.0 | 11.1[5] |
| Liquid Banking Assets / Tangible Banking Assets (%) | 16.3 | 17.5 | 24.1 | 29.1 | 26.9 | 22.8[5] |
| Gross Loans / Due to Customers (%) | 101.8 | 99.2 | 103.4 | 101.3 | 92.7 | 99.7[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 1964, BRB-Banco de Brasilia S.A. (BRB) is controlled by the government of the Federal District, in Brasilia, which holds 71.9% of the bank's total shares, while Instituto de Previdência dos Servidores do Distrito Federal (IPREV-DF), the pension fund of public employees from the government of the DF, holds 16.5% and the remaining 11.6% are free float. Although the bank is expanding operations geographically and is now present in eleven other different Brazilian states, its business remains predominantly concentrated in the DF region, with a focus on providing banking services to the federal public servants as well as to local companies.

As of March 2023, BRB had a national market share of 0.3% of assets, 0.6% deposits and 0.6% loans.

## Detailed credit considerations

### High credit growth along with macroeconomic headwinds will continue to weigh on asset quality

In March 2023, BRB's ratio of problem loans to gross loans[1] decreased to 1.1%, from 2.1% one year prior, but the decline was mainly driven by write-offs that accounted for 2.9% of loan book in the period. The expansion of the loan book by 41% in the twelve months up to March 2023 also favored the downward trend in the problem loan ratio.

Against a backdrop of elevated household indebtedness and inflation, industrywide delinquency metrics have been rising since January 2022 and BRB was particularly hit following the seasoning of its high risk credit cards portfolio that grew rapidly over recent years. We expect that the bank's accelerated credit expansion into new segments and regions amid a challenging operating environment will keep posing risks to asset quality over the next 12 months. BRB's business concentration on the DF, albeit reducing on the back of bank's geographic expansion strategy, remains elevated, making bank's asset risk vulnerable to the overall district's economic and fiscal performance.

The large and growing participation of low-risk payroll loans and mortgage financing in the bank's loan portfolio will, however, curtail a more significant deterioration in asset quality. As of March 2023, payroll loans accounted for 46.1% of total loans, followed by mortgage financing at 22.5%, consumer finance at 11.3%, credit cards at 5.7% and government loans at 4.1%. Credit operations with companies, mainly in the form of secured loans to small and midsized firms, represented just 10.4% of total loans as of the same date.

### Core capitalization remains pressured by strong loan book expansion

BRB's capital ratio, measured as TCE to risk-weighted assets (RWA), went down to 5.9% in March 2023, from 7.1% one year earlier, in line with diminished earnings and strong loan book growth. Our preferred measure of capitalization deducts from capital the intangible assets and a significant portion of deferred tax assets that, in our view, do not provide significant loss absorption, while we adjust the bank's RWA by applying a risk factor of 100% to its significant holdings of the Brazilian government securities, weighted 0% by local regulations. In regulatory terms, BRB reported in Q1 2023 a Common Equity Tier 1 (CET1) ratio of 7.6% and total capital of 14.9%.

In order to support the balance sheet growth, the bank had BRL396 million in additional tier 1 and BRL 1.4billion in tier 2 securities that accounted for 49% of total regulatory capital in March 2023, well above the 12% in December 2020, meaning a sharp change to the quality of its capital structure. We expect the bank's expansion strategy to keep straining core capitalization in the remainder of 2023 as the replenishment of the bank's capital base via earnings reinvestment should remain insufficient to support a projected balance sheet growth of about 20%.

### Profitability is declining in the face of squeezed interest margins and increased credit costs

BRB's net income to tangible assets ratio decreased to 0.5% in 2022 from 1.5% in 2021. The trend continued in Q1 2023, when, after adjusting for the non-recurring gain from a divestment, the ratio was -0.3%, down from 0.4% one year prior. BRB's funding costs have increased significantly since 2021, in line with the climb in the reference interest rate and bank's higher use of hybrid debt to support growth. Concurrently, bank's capacity to reprice loans is limited given the credit concentration on payroll and mortgage loans that are denominated in fixed rates and have long duration. As a result, BRB's net interest margin (NIM) has consistently declined over the last years, staying at 5.8% in Q1 2023.

Despite the recent decline in net income, BRB has a track record of adequate profitability metrics, benefiting from the large share of revenue originated from low-risk lending operations and the bank's access to low-cost funding. The bank's established presence in the DF region and its large client base of public servants is also positive for the origination of recurring revenue.

However, BRB's predominant focus on a geographic region may reduce its capacity to originate revenue relative to banks with a nationwide distribution footprint, as its performance remains highly correlated to a local economy. For the next 12 to 18 months, we expect BRB's profitability will face pressure from the heightened competition for loan origination in the bank's niche market and the persistence of above-trend credit costs.

While the bank's strategy of expanding toward new regions and business lines enhance diversification and earnings capacity in the medium term, it also entails execution risks and upfront operating investments that weigh on efficiency metrics. In 2022, BRB's cost to income ratio stayed at 82.3%, from 74.4% a year earlier.

### Expansion in core deposits has been underpinning bank's accelerated balance sheet growth

As of March 2023, BRB's total funding was comprised mostly of time deposits, with 61.7% of total funding. Saving deposits were 6.9% and demand deposits were 3.3%. Low-cost judicial deposits accounted for 44.7% of the total investors in time deposits, while individuals were 19.0%, government-related entities 18.2%, and companies 18.0%. The bank's funding structure was complemented by domestic bank notes (including subordinated bank notes) and on-lending.

BRB has reported low reliance on market funds, which accounted for only 8.8% of tangible banking assets (TBA) in March 2023, down from 13.2% a year earlier. The bank has a consistent track record of good access to core deposits and historically low use of more confidence-sensitive funding.

### Bank has channeled excess liquidity to back up loan growth

In March 2023, BRB's liquid banking assets were 16.3% of tangible banking assets, well below the 33.0% posted one year prior. The decrease can be explained by the use of the excess liquidity to originate loans at a strong pace, as reflected by a 41.3% loan growth in the twelve months ended March 2023. Compared with other regional banks, BRB has historically had a relatively lower position in terms of liquid assets, which is offset by bank's broad core deposits base.

### BRB's financial profile reflects Brazil's Moderate- Macro Profile

Brazil's macro profile of “Moderate-” is supported by the country's large scale and highly diversified economy, with limited exposure to external financing risk. Nonetheless, we expect a less benign operating environment for banks in 2023 as a result of a deceleration in economic activity, which stems from the central bank's restrictive monetary policy to curb inflationary pressure. We forecast a real GDP growth of 0.9% for 2023, showing a reduction from 3.0% in 2022. High unemployment and household indebtedness, aligned with a tightening monetary policy, will negatively affect loan growth to one-digit rate from the high-teen rates reported in 2022.

Despite these challenges, we expect banks' high volume of reserves for loan losses to comfortably absorb any increase in loan delinquency that will remain at high levels in 2023. Profit will be affected positively by high interest rates at new loan originations and at banks' high liquidity levels largely placed in government securities, but, at the same time, will be pressured by a rise in provision expenses. Banks will face little pressure on funding needs considering the ample volume of liquidity in the system.

## ESG considerations

### BRB-Banco de Brasilia S.A.'s ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 3
**ESG Credit Impact Score**

**CIS-3**
**Moderately Negative**

NEGATIVE IMPACT
POSITIVE IMPACT

For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

*Source: Moody's Investors Service*

BRB's ESG **CIS-3** indicates that ESG considerations have a limited impact on the current credit rating with potential for greater negative over impact over time because of concentrated government ownership and the high potential for senior manager turnover every four years upon change of gubernatorial administration.

Exhibit 4
**ESG Issuer Profile Scores**

| ENVIRONMENTAL | SOCIAL | GOVERNANCE |
|---|---|---|
| E-2 | S-4 | G-3 |
| Neutral-to-Low | Highly Negative | Moderately Negative |

*Source: Moody's Investors Service*

### Environmental
BRB faces low environmental risks, particularly considering its exposure to carbon transition risks is lower than sector's heat map. This is because of the bank's predominance of household loans in its credit portfolio, while exposure to corporate lending, which typically carry high carbon transition risks, is limited.

### Social
BRB faces high industrywide social risks related to customer relations, reflecting the large participation of retail lending in the bank's loan book. However, the bank focuses on mitigating these risks by investing in digitization to improve customer experience. The bank's moderate exposure to demographic and societal trends results from the large participation of civil servants in its client base.

### Governance
BRB faces moderate governance risks, reflecting mostly the bank's concentrated ownership by the government of the Federal District, and potential political interference in the bank's management. BRB's CEO is appointed by the governor of the federal district and

vetted by the central bank, which results in potential change of management every four years. However, the bank has focused on improving corporate governance to mitigate reputational risks and increasing financial transparency.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

## Support and structural considerations

### Notching considerations

In the absence of a bail-in resolution regime framework in Brazil, the ratings of subordinated debt, bank hybrids and contingent capital securities follow the additional notching guidelines, in accordance with our Banks rating methodology. In these cases, the approach takes into account other features specific to debt classes, resulting in additional notching from the Adjusted BCA of the issuer.

### Government support

We believe there is a low likelihood of government support for BRB's ratings, which reflects the bank's small share of deposits and assets in Brazil's banking system.

### 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 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 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.

#### BRB's CR Assessments are positioned at Ba3(cr)/Not Prime(cr)

The CR Assessment of Ba3(cr) is placed one notch above the Adjusted BCA of b1 based on our view that senior obligations represented by the CR Assessment will be more likely preserved than senior unsecured debt to minimize losses, avoid disruption of critical functions and limit contagion. This CR Assessment reflects an issuer's probability of defaulting on certain operating liabilities and other contractual commitments that are less likely to be subject to the application of a resolution tool to ensure the continuity of operations.

### 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.

#### BRB's CRRs are positioned at Ba3/Not Prime

BRB's global local- and foreign-currency CRRs are positioned at Ba3 and Not Prime, 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 Ba3 are positioned one notch below Brazil's foreign currency ceiling for deposits and debt obligations.

## Methodology and scorecard

### 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 5

**BRB-Banco de Brasilia 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 | 1.3% | baa2 | ↔ | ba3 | Geographical concentration | Loan growth |
| Capital | | | | | | |
| Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in) | 5.9% | caa2 | ↔ | caa1 | Expected trend | |
| Profitability | | | | | | |
| Net Income / Tangible Assets | -0.3% | caa2 | ↔ | b3 | Expected trend | |
| Combined Solvency Score | | b2 | | b2 | | |
| Liquidity | | | | | | |
| Funding Structure | | | | | | |
| Market Funds / Tangible Banking Assets | 8.0% | baa3 | ↔ | ba1 | Deposit quality | |
| Liquid Resources | | | | | | |
| Liquid Banking Assets / Tangible Banking Assets | 17.5% | ba3 | ↔ | ba3 | Quality of liquid assets | |
| Combined Liquidity Score | | ba1 | | ba2 | | |
| Financial Profile | | | | b1 | | |
| 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 | | | | ba3 - b2 | | |
| Assigned BCA | | | | b1 | | |
| Affiliate Support notching | | | | 0 | | |
| Adjusted BCA | | | | b1 | | |

| 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 | ba3 | 0 | Ba3 | Ba3 |
| Counterparty Risk Assessment | 1 | 0 | ba3 (cr) | 0 | Ba3(cr) | |
| Deposits | 0 | 0 | b1 | 0 | B1 | B1 |

[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 6

| Category | Moody's Rating |
|---|---|
| **BRB-BANCO DE BRASILIA S.A.** | |
| Outlook | Stable |
| Counterparty Risk Rating | Ba3/NP |
| Bank Deposits | B1/NP |
| Baseline Credit Assessment | b1 |
| Adjusted Baseline Credit Assessment | b1 |
| Counterparty Risk Assessment | Ba3(cr)/NP(cr) |

*Source: Moody's Investors Service*

## Endnotes

1 We consider problem loans the loans overdue and rated between E and H under Brazilian Central Bank's resolution 2,682/99. According to this resolution, loans in Brazil are classified on a risk scale from AA to H with the corresponding minimum provisioning levels: AA - 0%, A - 0.5%, B - 1%, C - 3%, D - 10%, E - 30%, F - 50%, G - 70% and H - 100%. Of note, BRB's problem loans as calculated by Moody's includes only installments past due rated between E and H, as reported by the Bank.

REPORT NUMBER 1375948

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