



Rating Action: Moody's upgrades Banco Modal's long-term national scale ratings, affirms global ratings; stable outlook

23 Dec 2019

New York, December 23, 2019 -- Moody's Investors Service, ("Moody's") has today upgraded the Brazilian national scale deposit ratings assigned to Banco Modal S.A. (Modal) to Baa1.br, from Baa2.br, and to BR-2, from BR-3, long- and short-term, respectively. Moody's also upgraded Modal's long-term national scale counterparty risk rating to A1.br, from A2.br. At the same time, Moody's affirmed Modal's local and foreign currency deposit ratings at B1 and Not Prime, baseline credit assessment (BCA) at b1 and long-term counterparty risk ratings at Ba3. The outlook on all ratings is stable.

A full list of the affected ratings and assessments is provided at the end of this press release.

RATINGS RATIONALE

The upgrade of Modal's national scale ratings reflects improvements in asset quality metrics resulting from the run-off of legacy corporate problem loans as the bank gradually shifts its operations to focus on digital investments and brokerage service from commercial lending. Because of its new business focus, Modal's profitability has benefited from increasing generation of non-interest income through its digital platform ModalMais, which also supports the upgrade of the national scale ratings.

The affirmation of Modal's b1 BCA and global deposit ratings reflects Moody's view that Modal's new business model will face the challenges posed by increasing competition in banking and retail brokerage from banks and fintechs, many of which are also investing in expanding distribution through digital channels. In 2018, Modal pioneered the offer of an integrated digital platform with both banking and brokerage services; however, competition for digital financial services has intensified as new participants have joined the market. In addition, low interest rates, which boosted Modal's profitability in 2019 due to a material decline in finding costs, will have less of an effect going forward as future rate cuts may be less frequent.

Since Modal's inception in the mid-90s, the bank has adapted its business model to market conditions and targeted additional businesses, including investment banking, merchant banking and trust services, although its primary focus has remained on middle market lending and asset management. As Modal is able to broaden its product offering and attract new investors, clients and depositors through ModalMais, the 2015-launched digital platform, the bank will reduce the earnings volatility that has been associated with its legacy loan book and with its merchant banking activities. As part of its strategic priorities, Modal will also focus on investment banking and capital market activities to strengthen origination of fee-based revenues in 2020. Modal's merchant banking has been downsized over the past two years, but it is still a source of volatility because of the limitations in forecasting the future valuation of related investments.

For 2020, we expect Modal's capitalization will improve along with increased earnings generation and lower risk weighted assets, which will reduce capital allocated to credit operations. In June 2019, Modal's core capital ratio, measured as tangible common equity (TCE) to risk weighted assets (RWA), was 7.8%. At this level, the ratio is low compared to that of similarly rated mid-sized banks.

Over the next 12 months, Modal's credit profile will benefit from the growing participation of retail-related deposits in the bank's funding structure. In June 2019, demand deposits accounted for 15% of the bank's total deposits compared to 0.6%, one year prior, a credit positive. Modal has also focused on raising time deposits from retail investors through its proprietary digital platform, reducing reliance on more volatile and expensive institutional investors.

Moody's believes Modal's exposure to environmental risks is low, consistent with its general assessment for the global banking sector. Modal's exposure to social risks is moderate, consistent with Moody's general assessment for the global banking sector. We do not have any particular governance concerns for Banco Modal. Nevertheless, the ongoing transformation of Modal's business pose execution and operational risks and requires ongoing monitoring.

WHAT COULD CHANGE THE RATING -- DOWN/UP

Modal's ratings could be upgraded if the bank is able to improve asset quality, profitability and capitalization metrics consistently. Consistent earnings origination derived from the expansion of its digital banking and brokerage platform, with subsequent reduction in earnings volatility, would be positive for ratings as well. A decline in the bank's exposure to risky merchant banking investments could also bring ratings up.

The ratings could be downgraded if the bank is unable to maintain adequate capitalization because of new net losses. Negative pressure on ratings could also materialize if earnings recurrence is disrupted by operating risks associated with its evolving digital platform.

METHODOLOGY USED

The principal methodology used in these ratings was Banks Methodology published in November 2019. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Banco Modal S.A. is headquartered in Rio de Janeiro, Brazil, and reported BRL3.4 billion (USD883 million) in assets and BRL350.5 million (USD91.4 million) in shareholders' equity as of 30 June 2019.

LIST OF AFFECTED RATINGS AND ASSESSMENTS

The following ratings of Banco Modal S.A. were upgraded:

- Long-term Brazilian national scale deposit rating to Baa1.br, from Baa2.br
- Short-term Brazilian national scale deposit rating to BR-2, from BR-3
- Long-term Brazilian national scale counterparty risk rating to A1.br, from A2.br

The following ratings and assessments of Banco Modal S.A. were affirmed:

- Long-term global local currency deposit rating of B1; stable outlook
- Short-term global local currency deposit rating of Not Prime
- Long-term foreign currency deposit rating of B1; stable outlook
- Short-term foreign currency deposit rating of Not Prime
- Short-term Brazilian national scale counterparty risk rating of BR-1
- Baseline credit assessment of b1
- Adjusted baseline credit assessment of b1
- Long-term counterparty risk assessment of Ba3(cr)
- Short-term counterparty risk assessment of Not Prime(cr)
- Long-term global local currency counterparty risk rating of Ba3
- Short-term global local currency counterparty risk rating of Not Prime
- Long-term global foreign currency counterparty risk rating of Ba3
- Short-term global foreign currency counterparty risk rating of Not Prime

..Outlook Actions:

....Outlook, Stable

Moody's National Scale Credit Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale credit ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".za" for South Africa. For further information on Moody's approach to national scale credit ratings, please refer to Moody's Credit rating Methodology published in May 2016 entitled "Mapping National Scale Ratings from Global Scale Ratings". While NSRs have no inherent absolute meaning in terms of default risk or expected loss, a historical probability of default consistent with a given NSR can be inferred from the GSR to which it maps back at that particular point in time. For information on the historical default rates associated with different global scale rating categories over different investment horizons, please see http://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1174796.

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