

CREDIT OPINION

18 February 2021

Update

 Rate this Research

RATINGS

Banco Cooperativo Sicredi S.A.

Domicile	Porto Alegre, Rio Grande do Sul, Brazil
Long Term CRR	Ba1
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Issuer Rating	Not Available
Type	Not Available
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 Cooperativo Sicredi S.A.

Update to credit analysis

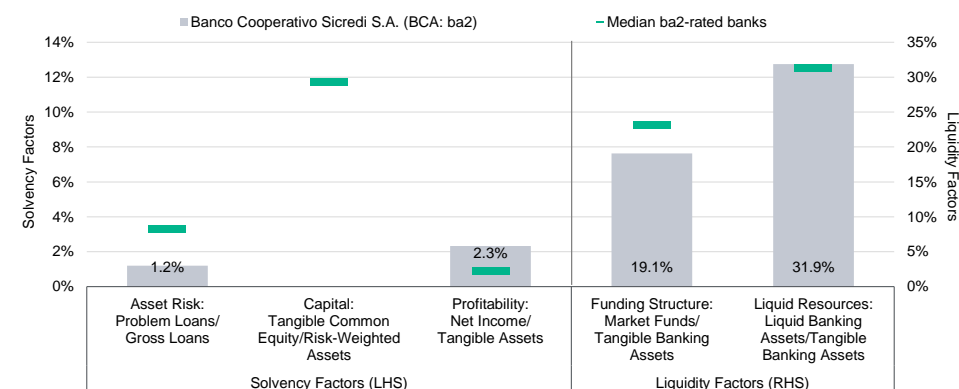
Summary

Moody's assigns a corporate family rating of Ba2 to [Banco Cooperativo Sicredi S.A.](#) (Banco Sicredi), which incorporates the cooperative system's consistently low asset risk, strong capitalization and profitability, and the granular funding structure that has supported Sicredi's rapid loan growth. Sicredi's ratings also reflect the complexities involved in operating a large federated cooperative system as well as the bank's loan concentration to the agricultural industry. Moody's assesses the Sicredi group as if it operated as a single entity, taking into consideration its strategic and operational cohesion, common policies for credit risk, liquidity risk and capitalization; as well as the principle of solidarity within the group. Banco Sicredi is the central entity of Sistema de Crédito Cooperativo Sicredi (Sicredi). As of June 2020, it congregates 109 financial cooperatives with over 4.6 million associates in 23 Brazilian states plus the Federal District, and offers traditional financial services to associates (such as lending, credit cards, insurance and investments) under the same brand and common risk policies. The recent coronavirus outbreak presents downside risks for Sicredi, as it does for most banks around the globe, and could lead to worsening asset quality and profitability, particularly as the economy decelerates sharply in 2020.

The Aa1.br Brazilian national scale CFR and issuer ratings reflects Sicredi's ability to maintain above average asset risk metrics during economic downturns as well as sustain its capitalization and profitability metrics at high levels that are on a par with similarly Aa1.br rated peers. Sicredi's ratings carry a stable outlook.

Exhibit 1

Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

- » Strong capitalization, both at the combined group and at each individual entity of the Sicredi network
- » Resilient profitability, largely driven by high margin lending operations and low cost of funding
- » High liquidity and granular funding structure, largely composed of cooperative associates' deposits

Credit challenges

- » Asset risk and profitability pressures due to the challenging operating environment in Brazil despite conservative risk management and below system average problem loans
- » Intrinsic limitations to franchise business flexibility and growth, due to cooperative model

Rating outlook

The outlook on all ratings is stable, in line with the outlook on Brazil's sovereign rating.

Factors that could lead to an upgrade

- » Sicredi's BCA is constrained by Brazil's sovereign rating and as result it would only face upward pressure in the event of an upgrade in Brazil's bond rating. As the outlook on Brazil's ratings is stable, there is limited possibility for an upgrade in Sicredi's ratings

Factors that could lead to a downgrade

- » Negative pressure on Sicredi's ratings would derive from significant weakening in its loan portfolio performance that pressures Sicredi's profitability and capital generation. A downgrade in Brazil's ratings would lead to a downgrade in Sicredi's ratings as well

Key Indicators

Exhibit 2

Banco Cooperativo Sicredi 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)	137.4	110.6	95.1	77.3	65.9	23.4 ⁴
Total Assets (USD Billion)	25.0	27.5	24.5	23.3	20.2	6.3 ⁴
Tangible Common Equity (BRL Billion)	18.3	17.0	14.5	12.4	10.5	17.2 ⁴
Tangible Common Equity (USD Billion)	3.3	4.2	3.7	3.7	3.2	0.9 ⁴
Problem Loans / Gross Loans (%)	1.1	1.1	1.1	1.4	2.0	1.4 ⁵
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	4.0	4.0	3.7	4.3	5.6	4.3 ⁵
Net Interest Margin (%)	8.0	9.4	9.3	10.1	11.3	9.6 ⁵
Net Income / Tangible Assets (%)	2.3	2.8	2.9	3.0	3.0	2.8 ⁵
Cost / Income Ratio (%)	54.4	56.7	57.6	59.2	57.2	57.0 ⁵
Market Funds / Tangible Banking Assets (%)	18.6	19.1	19.9	19.2	18.6	19.1 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	40.9	31.9	38.7	41.2	43.2	39.2 ⁵
Gross Loans / Due to Customers (%)	87.2	106.1	97.0	93.7	91.9	95.2 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.
Sources: Moody's Investors Service and company filings

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.moodys.com for the most updated credit rating action information and rating history.

Profile

Banco Cooperativo Sicredi is the central banking entity of Sistema de Crédito Cooperativo Sicredi (Sicredi Group, or the Group), a federated credit cooperative system in Brazil that, as of 30 June 2020, was comprised of 109 credit unions and more than 4.6 million depositors (members) with presence in 23 Brazilian states plus the federal district. The Sicredi Group offers traditional financial services to associates under a common brand and following centralized risk policies and controls. As per the cooperative culture, members of Sicredi's individual credit unions are also the shareholders of those credit unions.

Detailed credit considerations

Granular borrower exposure is positive, but strong loan growth could weigh on asset risk

Moody's assigns a ba2 score to Sicredi's asset risk, reflecting its granular, geographically diversified loan book and conservative provisioning policies. At the same time, the score incorporates our expectation that the seasoning of strong recent growth of Sicredi's loan portfolio, could lead to higher asset risk as well as our view on sector concentration.

As of June 2020, Sicredi's problem loans¹ ratio stood at 1.1%, slightly better than the 1.4% a year earlier, and well below the Brazilian banking system 90-day delinquency of 2.9% in June 2020. Sicredi's problem loans as calculated by Moody's includes only installments past due by 15 days or more.

Each one of the 109 credit unions within Sicredi's cooperative system provides loans and other traditional financial services to its own associates, mostly individuals from low to mid income classes and small farmers. As of June 2020, agribusiness was the dominant segment in Sicredi's loan book (34%), followed by loans to individuals (33%). Moody's notes that Sicredi actively monitors actual and potential environmental risk that could come from its loans to corporate associates and applies strict underwriting guidelines to manage its potential reputational risks associated with lending to such companies. According to Sicredi's bylaws, the largest borrower cannot exceed 20% of the regulatory Tier 1 capital of the credit union. Since individual credit unions are modest in size - with an average common equity Tier 1 of BRL70 million - and distributed over 23 different states plus the federal district in Brazil, Sicredi's asset exposure is more granular than other Ba rated commercial banks.

The group's internal regulation states that a credit union cannot provide new loans if it does not comply with the minimum liquidity, capital and asset risk thresholds established centrally by risk management, and a recovery plan must be implemented. In addition, each credit union must hold sufficient reserves to cover its problem loans, providing a relevant loss absorption buffer. However, Sicredi is exposed to the challenges faced by the Brazil because of the unexpected downturn in economic activity caused by the coronavirus pandemic, which will likely have a negative effect on Sicredi's asset quality in the next few quarters.

Strong capitalization supports Sicredi's creditworthiness

We score Sicredi's capital as baa1, given that Sicredi's credit unions report core capital ratios comfortably above the Brazilian average and above the ratios reported by groups with similar business model globally. Our assessment for capital also notes the gradual increase in the capitalization across the multiple credit unions over the past two years. In addition, in June 2020, the Central Bank of Brazil reduced the capital requirement to small financial institutions, including cooperatives, which has potential to increase credit by BRL16.5 billion system wide. Looking at nominal leverage, as of June 2020, the total loan book was 4.1 times its equity, which compares to leverage of around 3.9 times for the system.

According to internal regulations, each credit union must report capital ratios at least 300 basis points above regulatory minima, which ensures a solid position at the network level. The ratios are centrally monitored and noncompliant entities are only allowed to originate new credit operations under the supervision of regional centers. Credit unions whose capital ratios remain below internal thresholds must present plans to replenish capital. The group also benefits from regular reinvestment of net income in its capital structure.

In line with its cooperative nature, each of Sicredi's individual associates is a shareholder of the group and new joiners must make an equity injection to be entitled to membership. These contributions and the systematic earnings retentions are key sources of capital for the group and therefore its capital is almost exclusively made of common equity. In H1 2020, Sicredi's shareholder's equity increased by BRL1.3 billion, comprised of BRL1.6 billion as 2019 earnings, BRL607 million as shares issued to new members, withdrawals from members who left the group amounted to BRL244 million in the same period, and earnings distribution of BRL684 million.

Besides members contribution and internal earnings generation, a minor addition to regulatory capital comes from subordinated Tier 2 notes with the IFC (BRL104 million, due in 2021) and additional Tier 1 (BRL153 million, only at Banco Sicredi).

In terms of ownership, the local credit unions and the five regional centers are the shareholders of Sicredi Participações - the holding entity that controls Banco Cooperativo Sicredi. The Dutch group Rabobank and the International Finance Corporation (IFC) also have minority interests in the bank, with around 22.44% and 2.95% of its capital - respectively - which improves Sicredi's technical expertise and its incipient access to international markets.

Overall profitability reflects low cost of funding, but performance differs among credit unions

Although profit maximization is not Sicredi's main objective, given its cooperative model, the system has strong returns on its assets reporting a ratio of net income to tangible assets of 2.3% in H1 2020, from 3.0% a year earlier. The decline in the ratio is mainly due to the strong total assets expansion, which grew 38.5% in the last twelve months ended June 2020. The key driver for the strong profitability is the sizeable net interest margin on lending, roughly 400 bps above the average of Moody's rated banks in Brazil, as credit unions generate loans at market rates while benefiting from low-cost core funding (at 91% of the benchmark rate, on average) which has declined as the SELIC rate in Brazil has come down swiftly. In addition, credit cooperative income is also tax free in Brazil which boosts Sicredi's bottom line. Sicredi also provides insurance broker and credit card services, but these products represent roughly 6% of revenues.

Sicredi is present in more than a thousand cities and is the sole financial institution in 20% of them, which provides geographical diversification to earnings. At the same time, this characteristic weighs on Sicredi's operating expenses, as individual credit unions lack operational scale and must comply individually with regulatory demands from the Central Bank, including the reporting of audited financials. Our score of baa2 for Sicredi's profitability reflects the challenges the system faces in maintaining high profitability in light of coronavirus' effects on economic activity, particularly increasing in loan-loss provisions and reduced business volume, in addition to the low interest rate environment that will continue to strain margins.

Granular funding base supports adequate liquidity

Moody's scores Sicredi's combined liquidity at baa3, incorporating a baa3 score for funding structure and baa3 for liquid resources, which are driven by its stable, granular funding base and conservative liquidity management across the cooperative system.

As of June 2020, deposits and deposit-like instruments were its major funding source accounting for 80% of Sicredi's total funding. The second most important source are domestic onlendings operations from government-owned development bank BNDES - BRL10.7 billion - which are channeled through Banco Sicredi to the credit unions, and represent 10% of the system's funding. According to internal regulations, the minimum amount of liquidity established for each entity depends on the volatility of its funding availability, being higher for unions with higher deposit concentrations and noncompliant entities cannot disburse new loans. We understand such measures help to address the challenges imposed by the complex and heterogenic network and reinforce the cross guarantee in place.

Liquidity in the system is strong, with liquid assets accounting for almost 41% of tangible banking assets as of June 2020. Importantly, credit unions within the system are also protected by a cross guarantee whereby the system's credit unions support one another in the event that any of them have liquidity or capital needs through a centrally managed liquidity system operated by its banking entity. In addition, depositors at each cooperative have protection first from Sicredi's own guarantee funds and then from the national deposit guarantee fund for cooperatives (Fundo Garantidor do Coopertavismo de Credito).

Qualitative adjustments

Sicredi's cooperative model results in intrinsic limitations to its franchise in terms of business flexibility and growth. In addition, the cooperative system as a whole presents higher structural complexity, which derives from the heterogeneity of individual cooperative entities, than rated commercial banks. The comprehensive and timely risk monitoring by Banco Sicredi counterbalances this complexity. Nonetheless, in order to reflect this increased complexity, we assign a qualitative adjustment of -1 for opacity and complexity to Sicredi.

Sicredi's rating is supported by Brazil's Moderate - Macro profile

Brazil's Moderate- Macro Profile incorporates the country's large-scale and highly diversified economy, despite the sharp decline in growth in 2020 because of the negative effects of the pandemic. We expect Brazil's economy to contract by 5.7% in 2020 before

rebounding in 2021 with 3.3% growth. The pandemic will have a direct negative effect on Brazilian banks' profitability in 2020, and will weaken asset quality in 2021. However, we expect banks' pre-provision earnings generation to improve as business volumes benefit from a continued recovery of economic activity. Improving profit will support capital in the coming quarters. Our view of Brazil's operating environment also takes into consideration the challenges related to low government effectiveness and political developments that could still hurt the sweeping structural reform agenda. Brazil's Macro Profile also reflects the country's favorable credit conditions that will benefit from a low interest rate environment supporting credit demand, borrowers' repayment capacity and private consumption.

ESG considerations

Sicredi'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 expect 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 are partly mitigated by sizable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of 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 toward digital banking services increasing information technology costs, aging population concerns in several countries affecting the demand for financial services or socially driven policy agendas that may translate into regulations that affect banks' revenue base. See our [social risk heat map](#) for further information.

Governance is highly relevant for Sicredi, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for Sicredi we do not have any particular governance concerns [with only minor control issues and governance shortfalls identified in recent years remediated in the normal course of business]. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Notching considerations

In the absence of a bail-in resolution regime framework in Brazil, the ratings of subordinated debts, bank hybrids and contingent capital securities follow the "Additional Notching Guidelines", as per the Rating Methodology: Banks. In these cases, the approach takes into account other features specific to debt classes, resulting in additional notching from the adjusted baseline credit assessment (BCA) of the issuer.

Government support

We believe there is a low likelihood of government support for Sicredi'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 (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.

Sicredi's CR Assessment is positioned at Ba1(CR)/Not Prime(CR)

The CR Assessment of Ba1(cr) is one notch above the Adjusted BCA of ba2 based on our view that senior obligations represented by the CR Assessment will be more likely preserved than senior unsecured debt in order 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 Rating (CRR)

Counterparty Risk Ratings 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.

Sicredi's CRRs are positioned at Ba1/NP

Sicredi's global local-currency CRRs are positioned at Ba1 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.

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 Cooperativo Sicredi 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	1.2%	baa2	↔	ba2	Sector concentration	Loan growth
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	-	-	-	baa1	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	2.3%	a3	↔	baa2	Return on assets	Expected trend
Combined Solvency Score		baa1		baa3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	19.1%	ba1	↔	baa3	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	31.9%	baa3	↔	baa3		
Combined Liquidity Score		ba1		baa3		
Financial Profile				baa3		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				-1		
Corporate Behavior				0		
Total Qualitative Adjustments				-1		
Sovereign or Affiliate constraint				Ba2		
BCA Scorecard-indicated Outcome - Range				ba1 - ba3		
Assigned BCA				ba2		
Affiliate Support notching				0		
Adjusted BCA				ba2		

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	ba1	0	Ba1	Ba1
Counterparty Risk Assessment	1	0	ba1 (cr)	0	Ba1(cr)	
Senior unsecured bank debt	0	0	ba2	0	Ba2	

[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 COOPERATIVO SICREDI S.A.	
Outlook	Stable
Counterparty Risk Rating	Ba1/NP
Baseline Credit Assessment	ba2
Adjusted Baseline Credit Assessment	ba2
Counterparty Risk Assessment	Ba1(cr)/NP(cr)
Corporate Family Rating	Ba2
NSR Corporate Family Rating	Aa1.br
Issuer Rating -Dom Curr	Ba2

NSR Issuer Rating	Aa1.br
ST Issuer Rating -Dom Curr	NP
NSR ST Issuer Rating	BR-1

Source: Moody's Investors Service

Endnotes

- ¹ We consider as problem loans the loans overdue rated between E and H under Brazilian Central Bank's resolution 2,682/99.

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