CREDIT OPINION
21 June 2024

Update

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RATINGS

Banco do Estado do Rio Grande do Sul S.A.

Domicile	Porto Alegre, Rio Grande do Sul, Brazil
Long Term CRR	Ba2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Ba3
Type	LT Bank Deposits - Fgn Curr
Outlook	Negative

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.

Contacts

Lucas Viegas +55.11.3956.8717
VP-Senior Analyst
lucas.viegas@moodys.com

Daniel Girola +55.11.3956.8729
VP-Senior Analyst
daniel.girola@moodys.com

Guy Bernardet, CFA +55.11.3956.8789
Ratings Associate
guy.bernardet@moodys.com

Banco do Estado do Rio Grande do Sul S.A.

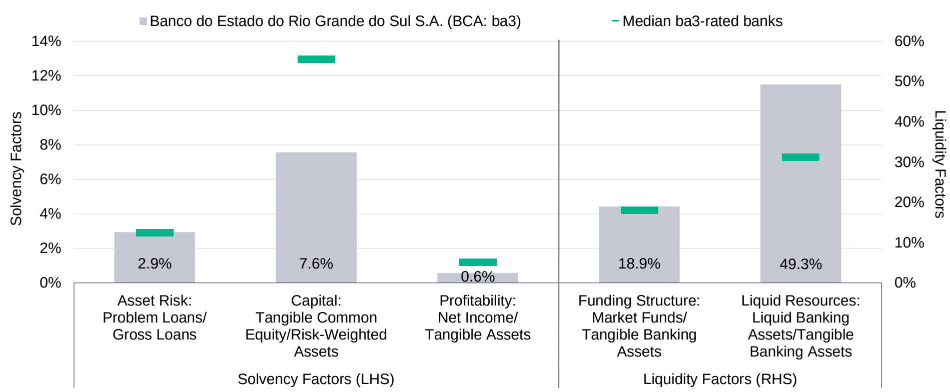
Update following rating affirmation and outlook change to negative

Summary

Banco do Estado do Rio Grande do Sul S.A. (Banrisul) has a Baseline Credit Assessment (BCA) of ba3, reflecting the bank's below average profitability and modest capitalization, compared to other local government banks in Brazil, counterbalanced by its predominantly and steady core funding structure, high levels of liquidity and adequate reserve coverage. The BCA acknowledges Banrisul's strong regional franchise whereby a relevant share of its deposits and operations are based within the state of Rio Grande do Sul (unrated), the bank's owner and controller.

The negative outlook reflects the bank's high concentration in the state of Rio Grande do Sul, and the uncertainty on the financial impacts as result of the climatic event. Banrisul's financial profile will likely be affected by a moderation in business volumes and higher credit impairments in the next quarters as result of the historical floods.

Exhibit 1
Rating Scorecard - Key financial ratios
As of March 2024



Note: Ratios are from Moody's banking scorecard. Capital ratio is as of most recent period; Asset Risk and Profitability ratios are the worse of the most recent year-to-date period or the average of the last three years and the most recent year-to-date; Funding Structure and Liquid Resources ratios are as of the most recent year-end.
Source: Moody's Financial Metrics

Credit strengths

» Stable low-cost core deposit funding, which is attributable to its leading regional franchise

» Ample liquid assets, which are largely invested in sovereign bonds

Credit challenges

» High regional concentration that limits the bank's footprint and earnings capacity.

» Asset risk and profitability challenges stemming from higher rates and modest economic growth

» The bank's limited flexibility in reducing operating costs to counter margin pressures or to invest in products and technology

Rating outlook

The negative outlook incorporates Banrisul's already modest profitability and capitalization, when compared to other large commercial banks in Brazil, that will likely be affected by a moderation in business volumes and higher credit impairments in the next quarters as a result of the historical floods that affected the Rio Grande do Sul state in May 2024

Factors that could lead to an upgrade

» Given the negative outlook, we do not anticipate upward pressures on Banrisul's ratings at this point.

Factors that could lead to a downgrade

» The bank's ratings could be downgraded in case of a sharp deterioration on asset quality, and consequently on profitability and capital with the materialization of medium term risks related to of the bank's businesses affected by recent climatic events. Sustainable core earnings generation, adequate liquidity and capitalization through the reconstruction of Rio Grande do Sul state would be material developments to stabilizing its ratings.

Key Indicators

Exhibit 2

Banco do Estado do Rio Grande do Sul S.A. (Consolidated Financials) [1]

	03-24[2]	12-23[2]	12-22[2]	12-21[2]	12-20[2]	CAGR/Avg.[3]
Total Assets (BRL Million)	129,228.7	125,063.7	113,166.2	104,575.8	91,822.9	11.1[4]
Total Assets (USD Million)	25,817.1	25,746.0	21,434.0	18,753.6	17,678.0	12.4[4]
Tangible Common Equity (BRL Million)	7,885.5	7,617.2	7,017.5	7,096.9	6,378.4	6.7[4]
Tangible Common Equity (USD Million)	1,575.4	1,568.1	1,329.1	1,272.7	1,228.0	8.0[4]
Problem Loans / Gross Loans (%)	2.9	2.6	2.1	2.4	2.8	2.5[5]
Tangible Common Equity / Risk Weighted Assets (%)	7.6	7.7	6.9	8.2	8.6	7.8[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	14.9	13.4	10.8	10.1	11.4	12.1[5]
Net Interest Margin (%)	5.1	4.9	4.5	5.1	6.3	5.2[5]
PPI / Average RWA (%)	2.7	2.5	1.8	2.6	3.6	2.7[6]
Net Income / Tangible Assets (%)	0.6	0.7	0.6	0.9	0.8	0.7[5]
Cost / Income Ratio (%)	67.9	68.4	75.7	69.2	66.9	69.6[5]
Market Funds / Tangible Banking Assets (%)	19.7	18.9	18.2	15.9	11.8	16.9[5]
Liquid Banking Assets / Tangible Banking Assets (%)	50.3	49.3	49.6	54.3	52.3	51.1[5]
Gross Loans / Due to Customers (%)	71.4	72.4	73.0	65.0	61.7	68.7[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 Ratings and company filings

Profile

Banrisul is a multiple-service bank controlled by the government of the Brazilian state of Rio Grande do Sul, which holds 98.1% of its common shares and 49.4% of total shares. Although the bank has operations across Brazil, its presence is concentrated in the country's southern region, primarily in the state of Rio Grande do Sul. As of December 2023, Banrisul had market shares of 35.5% of time deposits, 12.5% of savings, 33.8% of demand deposits and 20.1% of loans in Rio Grande do Sul. As of March 2024, the bank reported a consolidated asset base of BRL129.2 billion.

Detailed credit considerations

Asset risk metrics should deteriorate due to recent climatic event

With 85% of its operations in the state of Rio Grande do Sul, Banrisul's focus on secure consumer and agricultural loans has been able to maintain asset quality metrics below industry averages amid a high interest rate environment since 2021. As of March 2024, Banrisul's problem loans reached 2.9% of gross loans, from 2.3% one year prior, as high rates continued to pressure borrowers' repayment capacity, but still below the pre-pandemic average of 3.3%. The increase was mainly driven by higher delinquency, as measured by NPLs over 90 days, in the corporate and SME lending business that increased from 1.9% in March 2023 to 3.7% in March 2024. Banrisul maintained loan loss reserves at the comfortable level of 170% of problem loans in March 2024, providing a buffer against future charge offs and rising asset risk pressures. During the twelve months ended in March 2024, Banrisul grew its loan book by 7.5%, supporting delinquency metrics. Despite Banrisul's strategic focus on secured lending, future asset quality will be strained as the bank shifts gradually towards unsecured personal and SMEs loans in order to improve profitability.

As result of the historical floods in the state of Rio Grande Sul in May 2024, and the uncertainty regarding the severity of the losses we expect higher levels of non performing loans and renegotiation levels in the next quarters and consequentially increasing provisioning. Partially mitigating this risk, we acknowledge the bank's high liquidity levels and current manageable level of problem loans, that alongside government measures to alleviate the financial impact from the floods, brings resilience to Banrisul's financial profile

Banrisul's capitalization remains the weaker link on its credit profile

By Moody's preferred ratio of tangible common equity (TCE) to risk-weighted assets (RWA), capitalization is the weaker rating driver for Banrisul, with a capital ratio of 7.6% as of March 2024, that remained unchanged from March 2023. We deduct from capital the intangible assets and a significant portion of deferred tax assets that do not provide significant loss absorption, and we adjust the bank's RWA by applying a risk factor of 100% to its significant holdings of Brazilian government securities, weighted 0% by local regulations.

These adjustments are the cause of the difference between Moody's capital ratio and the regulatory CET1 ratio, which stood at 14.4% in March 2024, adequate as the bank continues its expansion plan and well above the regulatory minimum.

Profitability should continue pressured as result of high interest rates and the negative effects of the floods on credit risk

Over the past three years, profitability remained below the bank's historic average, mostly due to margin compression as a result of a sharp increase in the Selic rate, which impacted the bank's cost of funding, partly mitigated by the interest income from its sizeable government securities portfolio. In the first quarter of 2024, Banrisul's net income to tangible assets ratio was 0.6%, slightly down from 0.8% a year earlier. Although profitability was supported by a 40 bps year-over-year improvement in net interest margin, this was offset by higher loan loss provisions in line with the problem loans trend offset. Looking forward we expect Banrisul's proftiability to remain pressured as asset risk should be negatively affected by the recent climatic events likely to be translated into higher credit losses. Moreover, Banrisul's profitability will remain challenged by the competitive rate conditions in the payroll lending segment and the rate cap on these assets, which constrains the bank's net interest margin.

On the expense side, we incorporate in our analysis that as a state owned bank, Banrisul has less flexibility to reduce costs. In the first three months of 2024, recurring administrative expenses grew 6.8% compared with the same period of 2023, and recurring personnel expenses increased 5.4% in the same period. We also expect continued investments in digital transformation and infrastructure technology to strengthen information security and keep its competitive position in its regional market.

Core deposit base and ample liquidity are the cornerstone for Banrisul's credit profile

The ba3 BCA considers Banrisul's strong funding and liquidity position that are key credit strengths for the bank. Banrisul has a low reliance on market funds and stable core deposit funding base, with high levels of liquid assets, reflecting the bank's entrenched retail banking franchise in the regional market. As of December 2023, Banrisul held about 35% of time deposits, 12% of savings deposits and 34% of demand deposits in the state of Rio Grande do Sul.

As of March 2024, market funds represented 19.7% of its tangible banking assets, backed by a strong liquidity position, with liquid assets accounting for 50.3% of its tangible banking assets. Deposits represented the largest portion of the bank's funding structure, through a highly granular customer base that provided historical stability through the cycles, contributing to a low-cost funding structure compared to other similar size commercial banks in Brazil. The bank is considered a safe haven for depositors in Rio Grande do Sul and we expect the bank's deposit funding to remain stable. Notwithstanding, we expect a reduction on liquidity metrics looking forward as result of the forbearance Banrisul granted to its clients during the next quarters, as part of their support to the local community to relief the impacts of the recent floods. Funding diversification is to some extent provided by the issuance of banknotes (letras financeiras), subordinated debt and by local currency onlending from development banks, mainly Banco Nac. Desenv. Economico e Social - BNDES (Ba2 stable,ba2), which together accounted for 5.9% of total funding in March 2024.

Banrisul's rating is supported by the Moderate Macro Profile of Brazil

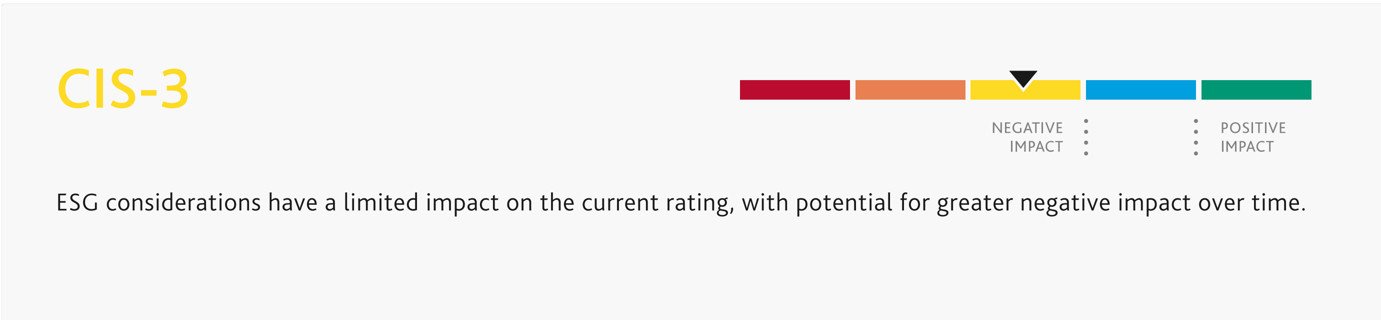
Brazil's (Ba2 positive) Macro Profile of “Moderate” is supported by the country's large and highly diversified economy with limited exposure to external financing risks. It also incorporates our improvements in the business environment for banks from recent reforms, including the independence of the central bank; the state-owned company law; labor reform; and a collateral framework that reduced uncertainties about judicial disputes and the potential for political intervention in the financial system. We forecast a real GDP growth to moderate in 2024 and 2025 to 2.0% after growing around 3.0% in the previous couple of years.

Our assessment acknowledges the current momentum as Brazil's banking system moves out of the credit cycle's downturn, with declining but still-high delinquency ratios and household indebtedness amid tighter liquidity on global capital markets, which will continue to pressure credit conditions ahead.

ESG considerations

Banco do Estado do Rio Grande do Sul S.A.'s ESG credit impact score is CIS-3

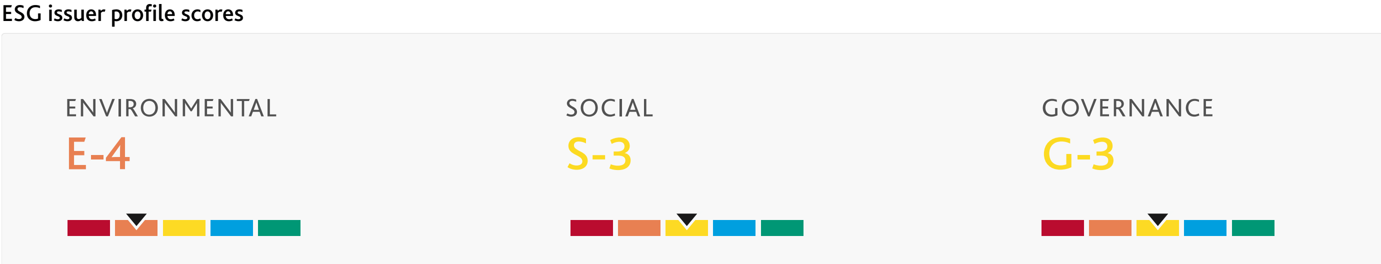
Exhibit 3
ESG credit impact score



Source: Moody's Ratings

Banrisul's **CIS-3** reflects the moderate credit impact of environmental and social factors on the rating to date. The **CIS-3** also incorporates the potential for governance risks to strain the rating over time, in particular stemming from the bank's 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



Source: Moody's Ratings

Environmental

Banrisul faces high exposure to environmental risks due to its physical and climate risks associated with its geographical concentration on Rio Grande do Sul that exposes the bank to severe climate events. The bank has limited exposure to carbon transition risks because its loan book is concentrated in loans to individuals, comprised mostly of payroll deductible loans to civil servants in the State of Rio Grande do Sul and to the national social security service (INSS) pensioners.

Social

Banrisul faces moderate social risks related to customer relations. The bank's developed policies and procedures, mitigate risk associated with the distribution of financial products such as conduct, regulatory and reputational risks, as well as exposure to litigation; Banrisul has activities primarily in Brazil, a country which has imposed only moderate penalties in relation to consumer protection. Continued investments in technology and the bank's long track record of handling sensitive customer data, as well as appropriate culture and governance that ensure adherence to regulatory standards, help to manage high cyber and personal data risks.

Governance

Banrisul's governance risks are moderate, reflecting mostly its concentrated ownership by the government of the State of Rio Grande do Sul, and potential political interference in the bank's management. Banrisul's senior management is appointed by the government, which results in potential change of management every four years. However, the bank follows corporate governance practices of publicly traded companies, therefore, mitigating 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 debts, bank hybrids and contingent capital securities follow the “Additional Notching Guidelines,” as per the Banks 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 Banrisul's ratings, which reflects the bank's small share of deposits and assets in Brazil's banking system.

Counterparty Risk Ratings (CRRs)

Banrisul's CRR is positioned at Ba2/Not Prime.

The Ba2 CRR assigned to Banrisul is in line with its Counterparty Risk (CR) Assessment of Ba2(cr) and is one notch above its ba3 Adjusted BCA. This is based on our view that the debt outstanding at Banrisul provides greater loss protection for its CRR obligations, thereby lowering the severity of loss on such obligations.

Counterparty Risk (CR) Assessment

Banrisul's CR Assessment is Ba2(CR)/Not Prime(CR).

The CR Assessment of Ba2(cr) is one notch above the Adjusted BCA of ba3 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.

Rating methodology and scorecard factors

Exhibit 5

Banco do Estado do Rio Grande do Sul 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	2.9%	baa2	↔	b1	Geographical concentration	Expected trend
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	7.6%	b3	↔	b3	Expected trend	
Profitability						
Net Income / Tangible Assets	0.6%	ba2	↔	b1	Expected trend	
Combined Solvency Score		ba2		b2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	18.9%	baa3	↔	ba1	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	49.3%	baa1	↔	baa3	Stock of liquid assets	Expected trend
Combined Liquidity Score		baa2		ba1		
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				ba3		
Affiliate Support notching				0		
Adjusted BCA				ba3		

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	ba2	0	Ba2	Ba2
Counterparty Risk Assessment	1	0	ba2 (cr)	0	Ba2(cr)	
Deposits	0	0	ba3	0	Ba3	Ba3
Dated subordinated bank debt	-2	0	b2	0		B2 (hyb)

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Ratings

Ratings

Exhibit 6

Category	Moody's Rating
BANCO DO ESTADO DO RIO GRANDE DO SUL S.A.	
Outlook	Negative
Counterparty Risk Rating	Ba2/NP
Bank Deposits	Ba3/NP
Baseline Credit Assessment	ba3
Adjusted Baseline Credit Assessment	ba3
Counterparty Risk Assessment	Ba2(cr)/NP(cr)
Subordinate	B2 (hyb)

Source: Moody's Ratings

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CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454