

**Rating Action: Moody's affirms Banco Modal's ratings, positive outlook**

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11 Jan 2022

New York, January 11, 2022 -- Moody's Investors Service ("Moody's") has today affirmed all ratings and assessments assigned to Banco Modal S.A. (Modal), including the long- and short-term local and foreign currency deposit ratings of Ba3 and Not Prime, respective, as well as the bank's baseline credit assessment (BCA) of ba3. At the same time, Moody's changed the outlook on Modal's ratings to positive, following the announcement published on 7 January 2022 that XP Inc. plans to acquire Banco Modal, a transaction expected to be concluded over the outlook horizon.

A full list of ratings and assessments can be found at the end of this press release.

**RATINGS RATIONALE**

The affirmation of Modal's ratings reflects the bank's improved asset risk metrics, its strong capitalization and its profitability that has been improving sustainably over the past 4 quarters. The BCA also acknowledges Modal's consistent reduction in the reliance of institutional funding sources and the higher liquidity levels held by the bank in the past 12 months, factors supported by a growing retail base of deposits.

Moody's decision to assign a positive outlook to Modal's ratings follows the publication of a Material Fact that Banco Modal S.A. has entered into a binding memorandum of understanding under which XP Inc. (Ba2 stable, XP) will acquire 100% of Modal's shares. Following the conclusion of this transaction, Modal will become part of XP's ecosystem and investment product and banking services, which will enhance the bank's funding and earnings capacity by leveraging its assets under custody (AUC) and customer growth potential. Modal's funding structure will likely benefit from having a large and profitable shareholder that will provide it opportunities to reinforce its retail and institutional funding base at an even lower cost.

In 2016, Modal started a change of its business model by investing in an open architecture investment platform, modalmais, integrated with full digital banking capabilities focused on middle income retail clients as well as investment banking services amid the growing financial services opportunities created by Brazil's deepening capital markets. Through its retail investment service platform, the bank reached BRL31 billion in assets under custody as of September 2021, up by 117% versus a year earlier. XP was founded in 2001 and has become a leading position as a full-service securities company offering a broad array of market-making and brokerage services to retail and institutional clients in Brazil's growing capital markets. As of September 2021, XP reported AUC BRL789 billion, up by 40% year over year due to its large and broad product offering and client base, which Modal will be able to target post acquisition.

Modal's tangible common equity (TCE) to risk weighted assets (RWA) ratio was at 25.1% as of June 2021, up from 16.4% at the end of 2020, following the injection of BRL1.2 billion through an IPO which was concluded in April 2021. This capitalization will continue to support Modal's future growth plans in the competitive Brazilian investment market, providing comfortable buffers against rising asset risks as the bank increases its retail lending operation to investment service customers. Asset risks also improved in 2021, reflecting the completed run off of its legacy mid-sized corporate loan book by 2019, and the recent expansion of its loan book over the past two years. In June 2021, problem loan ratio reduced to 0.7% of gross loans from 2.5% at the end of 2020. However, asset risk will remain challenged by the bank's rapid loan growth projected for the next two years, and by its strategy in capital market activities that will also add credit risks. The legacy private equity investments still carried on its balance sheet accounted for 4.1% of total assets in June 2021.

Modal's Ba3 deposit ratings also recognizes a growing participation of retail-related deposits in the bank's funding mix, with demand and time deposits representing 41% of total third-party resources as of June 2021, which has been helped by its proprietary digital platform that diminished the bank's reliance on more volatile and expensive institutional investors' resources.

Although, we do not have any particular governance concerns for Banco Modal, the ongoing transformation and expansion of its business model pose execution and operational risks and requires ongoing monitoring.

The acquisition by XP is dependent on approval by Brazil's antitrust authority, Brazil's Central Bank as well as

Modal shareholders. Moody's expects to maintain the positive outlook during the regulatory approval process.

#### FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Positive upward movement would arise at the materialization of the acquisition of Modal's shares by XP and the conclusion of regulatory approvals. Following the completion of the transaction, Modal's ratings would also consider support from XP that would be provided in a moment of stress.

Improved profitability, sustained capitalization at higher levels and lower reliance on market funding would also be positive implications for the bank's BCA.

Downward rating pressure does not exist at present given the positive outlook.

#### ISSUERS AND RATINGS AFFECTED

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

- Long-term local and foreign currency deposit ratings of Ba3, positive from stable outlook
- Short-term local and foreign currency deposit ratings of Not Prime
- Long-term local and foreign currency counterparty risk ratings of Ba2
- Short-term local and foreign currency counterparty risk rating of Not Prime
- Baseline credit assessment of ba3
- Adjusted baseline credit assessment of ba3
- Long-term counterparty risk assessment of Ba2(cr)
- Short-term counterparty risk assessment of Not Prime(cr)

..Outlook Actions:

...Outlook, positive from stable

The principal methodology used in these ratings was Banks Methodology published in July 2021 and available at [https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC\\_1269625](https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_1269625). Alternatively, please see the Rating Methodologies page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

#### REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: [https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC\\_79004](https://www.moody.com/researchdocumentcontentpage.aspx?docid=PBC_79004).

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