

O-Bank Co. Ltd.

Full Analysis

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Issuer Credit Rating

twA/Stable/twA-1

Major Rating Factors

Strengths

- Strong capitalization on a consolidated basis.
- Consistent management strategy somewhat offsets O-Bank's moderate revenue stability.

Weaknesses

- Limited market position and moderate revenue stability considering the development stage of its retail banking business.
- Below-average risk position mainly reflecting a somewhat more concentrated credit exposure.

Outlook: Stable

The stable outlook reflects our expectation that **O-Bank Co. Ltd.** will pursue a prudent capital policy to maintain its strong consolidated capitalization over the next one to two years. This is despite our view that it is at the lower borderline of our assessment for strong capitalization and constrained by the bank's above-average growth appetite and the development stage of its retail banking business. Meanwhile, we expect O-Bank to benefit from access to more diversified and stable retail funding sources as the bank gradually establishes its retail franchise over the longer term. Nevertheless, we expect it to take time for fundamental improvement in terms of diversity in the bank's business and funding profile.

Downside scenario

We may lower the long-term rating if the bank's strong capitalization weakens, as measured by a risk-adjusted capital (RAC) ratio before diversification consistently below 10% on a consolidated base over the next two years. This could result from higher business expansion or more aggressive capital plans than we originally expected.

Upside scenario

We may raise the rating if the bank can significantly improve its risk position and funding structure. Such improvement could include but is not limited to, a significant improvement in loan concentration to be comparable to the industry average with a manageable new retail risk exposure. At the same time, the bank would have to demonstrate sustainable retail deposit growth momentum with a funding mix that is more comparable to the industry average. However, we believe an upgrade to be remote in the coming one to two years.

Rationale

The ratings on O-Bank benefit from the bank's strong capitalization and consistent management strategy, in our view. Counterbalancing these strengths are the bank's limited market position and moderate revenue stability. The ratings also reflect O-Bank's somewhat higher risk position compared with that of its domestic peers, and below-average funding and adequate liquidity which is primarily limited by the bank's reliance on wholesale funding. O-Bank, formerly Industrial Bank of Taiwan, has transformed into a commercial bank and launched its retail business operation in 2017.

Anchor: 'bbb' for a bank operating mainly in Taiwan

Our bank criteria use S&P Global Ratings' Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating.

The anchor for a bank operating mainly in Taiwan is 'bbb'. On a consolidated base, O Bank's major credit exposure is in Taiwan (65%-70%), followed by Hong Kong (10%-15%) and the United States (10%) as of the end of December 2018. The BICRA score is informed by our evaluation of economic risk; we view Taiwan as a middle-income, moderately stable economy with a dynamic private sector and strong household net financial positions. Growth in private sector credit and housing prices is moderate. These factors partially offset the somewhat high level of private sector indebtedness in Taiwan.

With regard to industry risk, we characterize Taiwan's banking sector as highly competitive and fragmented. This results in low earning capacity to cushion against potential credit costs during economic downturns. Nonetheless, very strong and stable system-wide funding partly offset these weaknesses.

Table 1 | [Download](#)

O-Bank Co. Ltd. Key Figures (Year ended December 31)

(MIL. NT\$)	2018	2017	2016	2015	2014
Adjusted assets	560,672	539,434	495,652	484,721	426,846
Customer loans (gross)	200,290	182,768	164,997	148,924	133,541
Adjusted common equity	44,245	43,393	42,543	42,398	41,562
Operating revenues	7,822	7,919	7,756	7,721	7,141
Noninterest expenses	4,604	4,176	3,537	3,565	3,276
Core earnings	1,940	2,101	2,790	3,035	2,930

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Business position: Concentrated business portfolio constrains revenue stability

O-Bank's business position is moderate in our view, which reflects the bank's limited market position in Taiwan's competitive banking market and moderate revenue stability concentrated on corporate banking business. In our view, O-Bank has good expertise and a well-established franchise in corporate lending, despite the bank's limited market share with just 0.6% of both total domestic deposits and loans, as of the end of 2018. The bank has improved its revenue profile over the past few years, with recurring net interest income and fee income representing the majority of total revenue, compared to a previous revenue mix in which a significant contribution was from market-sensitive trading income. Nonetheless, the bank's revenue stability remains heavily affected by its corporate banking business. However, O-Bank has demonstrated a stable operating performance over the past five years with regards to its corporate banking business, despite economic volatility during the period.

We expect O-Bank's retail business to remain small relative to its total portfolio over the next one to two years, given the bank only began commercial banking operations in 2017. O-Bank competes by targeting online retail services, and it will take time and resources to build up the retail franchise from scratch in the overcrowded domestic banking market. Therefore, we expect the bank's market position to remain concentrated on corporate banking business over the next one to two years.

Table 2 | [Download](#)

O-Bank Co. Ltd. Business Position (Year ended December 31)

(%)	2018	2017	2016	2015	2014
Loan market share in country of domicile	0.6	0.6	0.6	0.5	0.5
Deposit market share in country of domicile	0.6	0.5	0.5	0.5	0.4
Return on average common equity	6.7	7.0	9.6	10.0	9.9

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Capital and earnings: strong capitalization to absorb unexpected losses

O-Bank's capital and earnings are strong, on a consolidated basis, and serve as a cushion against unexpected losses. The bank's RAC ratio was 10.5% at the end of 2018, reflecting strong loan growth and the bank's New Taiwan dollar (NT\$) 3 billion preferred stock issuance which we view to have intermediate equity content. The consolidated basis includes the group's subsidiary, China Bills Finance Corp.

Under our base case scenario, we expect O-Bank to maintain its strong capitalization supported by the bank's prudent capital management. That said, we expect the bank's likely above-average loan expansion over the next two years to trim its strong capital buffer, given O-Bank's strong growth appetite and the still-early stage of its retailed banking business. We expect the RAC ratio to trend down to 9.8%-10.0% over the next one to two years. Our borderline strong capitalization assessment, as reflected by the projected RAC ratio, is mitigated by the bank's high quality of capital, with total adjusted capital comprised almost entirely of adjusted common equity. We don't expect the quality of O-Bank's capital to weaken over the next two years. Additionally, the bank's ongoing disposal of its direct investment portfolio--at the regulator's requirement--will help to mitigate the bank's market risk and provide a buffer for its capitalization during times of market volatility.

We expect the bank to remain consistently profitable in the coming few years, albeit with high expenses incurred from the development of retail banking business is likely to pressure its profitability in the near term.

Table 3 | [Download](#)

O-Bank Co. Ltd. Capital And Earnings (Year ended December 31)

(%)	2018	2017	2016	2015	2014
Tier 1 capital ratio	11.3	11.1	11.9	13.0	12.7
S&P RAC ratio before diversification	10.5	9.9	10.5	10.8	12.1
S&P RAC ratio after diversification	8.1	7.8	9.1	9.3	10.5
Adjusted common equity/total adjusted capital	90.9	98.3	100.0	100.0	100.0
Double leverage	N.M.	N.M.	N.M.	N.M.	N.M.
Net interest income/operating revenues	54.0	58.0	53.5	44.7	37.9
Fee income/operating revenues	22.7	23.5	26.0	22.0	20.4
Market-sensitive income/operating revenues	21.2	16.3	19.0	31.0	40.2
Noninterest expenses/operating revenues	58.9	52.7	45.6	46.2	45.9
Provision operating income/average assets	0.6	0.7	0.9	0.9	0.9

Full Analysis: O-Bank Co. Ltd.

Core earnings/average managed assets 0.4 0.4 0.6 0.7 0.7

N.M.--Not meaningful. Note: We have adopted a revised RAC framework since 2016. Copyright © by Taiwan Ratings Corp. All rights reserved.

Table 4 | [Download](#)

O-Bank Co. Ltd. RACF [Risk-Adjusted Capital Framework] Data

(Mil. NT\$)	Exposure*	Basel III RWA	Average Basel III RW (%)	S&P Global Ratings RWA	Average S&P Global Ratings RW (%)
Credit risk					
Government and central banks	36,108	0	0	1,083	3
Of which regional	11	0	0	0	4
Institutions and Central Counterparty	43,003	12,050	28	13,867	32
Corporate	302,574	279,588	92	265,648	88
Retail	15,884	12,000	76	8,964	56
Of which mortgage	6,362	3,538	56	1,822	29
Securitization§	0	0	0	0	0
Other assets	7,614	4,325	57	7,801	102
Total credit risk	405,183	307,963	76	297,363	73
Credit valuation adjustment					
Total credit valuation adjustment	--	100	--	0	--
Market risk					
Equity in the banking book†	3,830	3,830	100	38,300	1,000
Trading book market risk	--	76,238	--	114,356	--
Total market risk	--	80,068	--	152,656	--
Operational risk					
Total operational risk	--	9,263	--	14,848	--
(Mil. NT\$)		Basel III RWA		S&P Global Ratings RWA	% of S&P Global Ratings RWA
Diversification adjustments					
RWA before diversification		397,393	--	464,867	100
Total Diversification/ Concentration Adjustments		--	--	132,727	29
RWA after diversification		397,393	--	597,594	129
(Mil. NT\$)		Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global RAC ratio (%)
Capital ratio					
Capital ratio before adjustments		44,288	11.3	48,695	10.5
Capital ratio after adjustments‡		44,288	11.3	48,695	8.1

*Exposure at default. §Securitisation Exposure includes the securitisation tranches deducted from capital in the regulatory framework. †Other assets includes Deferred Tax Assets (DTAs) not deducted from ACE. ‡Adjustments to Tier 1 ratio are additional regulatory requirements (e.g. transitional floor or Pillar 2 additions). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. NT\$--New Taiwan Dollar. Sources: Company data as of Dec. 31, 2018, S&P Global. Copyright © by Taiwan Ratings Corp. All rights reserved.

Risk position: Constrained by higher credit risk concentration

O-Bank has somewhat higher risk than the domestic peer average, which is mainly attributable to the bank's high credit risk concentration on corporate lending and new uncertainties facing the bank following its retail business expansion, offset by the disposal of its direct investment portfolio.

O-Bank's higher credit risk concentration on corporates than the local peer average is mainly due to the bank's prior wholesale business nature as an industrial bank. We expect O-Bank's lending portfolio

to remain concentrated on corporates, given the bank's retail lending business is likely to remain relatively small over the short term. At the same time, we see several new uncertainties over the bank's retail book in terms of growth and changes to its risk exposure at the initial stage of its retail banking operation. Nevertheless, we expect the disposal of its direct investment business to somewhat alleviate its risk complexity.

Table 5 | [Download](#)

O-Bank Co. Ltd. Risk Position (Year ended December 31)

(%)	2018	2017	2016	2015	2014
Growth in customer loans	9.6	10.8	10.8	11.5	13.5
Total diversification adjustment / S&P RWA before diversification	28.6	27.4	16.2	16.5	15.3
Total managed assets/adjusted common equity (x)	12.7	12.5	11.7	11.5	10.3
New loan loss provisions/average customer loans	0.3	0.5	0.4	0.3	0.2
Net charge-offs/average customer loans	0.2	0.1	0.3	0.1	0.0
Gross nonperforming assets/customer loans + other real estate owned	0.0	0.2	0.0	0.2	0.3
Loan loss reserves/gross nonperforming assets	10,799.0	645.5	8,657.6	693.0	632.8

Note: We have adopted a revised RAC framework since 2016. Copyright © by Taiwan Ratings Corp. All rights reserved.

Funding and liquidity: Below average, given the bank's gradual development of retail funding sources

O-Bank's funding is below average and its liquidity is adequate in our opinion, reflecting the bank's somewhat higher reliance on wholesale funding compared to its Taiwan banking peers. Although the bank will gradually benefit from its commercial license, retail deposits remain a relatively small portion of its total deposit base (about 10% as of the end of 2018), and the bank still primarily obtains funds through wholesale deposits. O-Bank's stable funding ratio was 113.2% as of the end of 2018, which is a significant improvement from the same time in 2017, as a result of the bank's deposit-taking efforts. Despite largely narrowing the gap for its stable funding ratio with that of its domestic peers, we believe it will take time for O-Bank to fundamentally enhance the diversification of its funding profile, given keen industry competition and O-Bank's limited branch network. This is despite our view that the bank could have access to more diversified and stable funding sources along with retail funding growth.

We view O-Bank's liquidity as adequate, given its broad liquid assets to short term funding ratio was 1.3x in 2018, indicating sufficient liquidity to cover its short term liabilities.

Table 6 | [Download](#)

O-Bank Co. Ltd. Funding And Liquidity (Year ended December 31)

(%)	2018	2017	2016	2015	2014
Core deposits/funding base	53.8	42.7	43.4	42.3	44.2
Customer loans (net)/customer deposits	75.4	90.8	88.1	84.8	83.7
Long term funding ratio	61.0	51.5	52.9	51.3	54.6
Stable funding ratio	113.2	95.7	100.0	100.8	104.3
Short-term wholesale funding/funding base	42.9	53.3	52.0	54.1	51.0
Broad liquid assets/short-term wholesale funding (x)	1.3	1.1	1.1	1.1	1.2
Net broad liquid assets/short-term customer deposits	28.6	12.6	17.0	20.6	28.3
Short-term wholesale funding/total wholesale funding	91.2	92.7	91.9	93.7	91.4

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Related Criteria

- Criteria | Financial Institutions | Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - January 29, 2015
- TRC Financial Services Sector Issue Credit Rating Criteria, www.taiwanratings.com - September 23, 2014
- General Criteria: Group Rating Methodology - November 19, 2013
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology - July 20, 2017
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions - July 17, 2013
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions - November 09, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions - November 09, 2011
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com - June 26, 2018
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

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Ratings Detail (As of July 29, 2019)

TRC Current Ratings	Issuer Credit Rating	twA/Stable/twA-1
Issuer Credit Rating History	2010/03/08	twA/Stable/twA-1
	2009/03/03	twA/Negative/twA-1

Full Analysis: O-Bank Co. Ltd.

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