

# 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 due to its concentrated banking portfolio.
- Somewhat higher credit risk concentration compared with the industry average.

## Outlook: Stable

The stable outlook reflects our expectation that **O-Bank Co. Ltd.** will maintain its strong consolidated capitalization over the next one to two years, underpinned by prudent capital policies. Meanwhile, we expect the 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 the bank's business and funding diversity.

### Downside scenario

We may lower the long-term rating on O-Bank 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, and a manageable new retail risk exposure. At the same time, the bank would have to demonstrate sustainable retail deposit growth with a funding mix 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, coupled with moderate revenue stability as a result of its concentration on corporate banking business. We view the bank has higher risks than its domestic peers', reflecting a concentrated credit exposure on corporate lending.

### 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.

On a consolidated base, the 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 2017. As a result, the anchor for O-Bank mainly reflects the bank anchor in Taiwan of 'bbb'. 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 Dec. 31)

(Mil. NT\$)	2017	2016	2015	2014	2013
Adjusted assets	539,432	495,652	484,721	426,846	391,872
Customer loans (gross)	182,768	164,997	148,924	133,541	117,644
Adjusted common equity	43,391	42,543	42,398	41,562	40,389
Operating revenues	7,919	7,756	7,721	7,141	6,169
Noninterest expenses	4,176	3,537	3,565	3,276	2,983
Core earnings	2,115	2,768	3,035	2,930	2,344

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### Business position: Concentrated business portfolios constrain 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 O-Bank's moderate revenue stability concentrating 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 0.5% and 0.6% of total domestic system deposits and loans, respectively, as of the end of 2017. O-Bank's business stability has been improving over the past few years, with recurring income streams representing an increasing percentage of the bank's total revenue with a material albeit decreasing contribution from trading income. In addition, the bank has demonstrated a stable operating performance on its corporate banking business over the past five years, despite economic volatilities during the period.

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Meanwhile, we expect O-Bank's retail business to remain small relative to its total portfolio over the short term, given the bank only commenced its commercial bank operations in 2017. O-Bank plans to compete 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 heavily reliant on corporate banking business over the next one to two years.

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

(%)	2017	2016	2015	2014	2013
Loan market share in country of domicile	0.6	0.6	0.5	0.5	0.4
Deposit market share in country of domicile	0.5	0.5	0.5	0.4	0.4
Total revenues from business line (mil. NT\$)	7,919	7,756	7,721	7,141	6,169
Reported return on equity	7.2	9.3	10.0	9.9	8.2

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### Capital and earnings: Strong capitalization on a consolidated basis

We assess O-Bank's capital and earnings as strong, on a consolidated basis, in the coming one to two years. This strong capitalization is supported by the bank's prudent capital policy and ongoing disposal of its direct investment portfolio, while counterbalanced by its above-average loan growth. The consolidated basis includes the group's subsidiary, China Bills Finance Corp, over which O-Bank has effective control at board level.

O-Bank's RAC ratio declined to 9.9% as of the end of 2017, reflecting the bank's strong loan growth and an increase in market risk along with the bank's expanding investment portfolio. These factors were offset by the bank's New Taiwan dollar (NT\$) 750 million hybrid Tier 1 issuance in 2017 that qualifies as intermediate equity content, in our assessment.

That said, we expect O-Bank to maintain its strong capitalization in our base-case assumption. Our forecast includes the bank's NT\$700 million hybrid Tier 1 issuance in 2018, which we also assess as having intermediate equity content. In addition, we assume the bank will maintain its prudent capital management and sustain a RAC ratio above 10% over the next one to two years as it actively pursues business expansion. This is despite our projection of O-Bank's strong loan growth over the next two years, which we expect to weaken the bank's RAC ratio slightly. Additionally, O-Bank's ongoing disposal of its direct investment portfolio at the regulator's request will help mitigate its market risk and provide a buffer for its capitalization.

On a positive note, we view the quality of O-Bank's capital as high, given its total adjusted capital is comprised almost entirely of adjusted common equity. We expect the bank's profitability to remain moderate and subject to high expenses incurred from the development of its retail banking.

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

(%)	2017	2016	2015	2014	2013
Tier 1 capital ratio	11.1	11.9	13.0	12.7	13.4
S&P RAC ratio before diversification	9.9	10.5	10.8	12.1	10.7
S&P RAC ratio after diversification	7.8	9.1	9.3	10.5	9.2
Adjusted common equity/total adjusted capital	98.3	100.0	100.0	100.0	100.0
Double leverage	N.M.	N.M.	N.M.	N.M.	N.M.
Net interest income/operating revenues	58.0	53.5	44.7	37.9	34.6
Fee income/operating revenues	23.5	26.0	22.0	20.4	20.0
Market-sensitive income/operating revenues	16.3	19.0	31.0	40.2	40.9
Noninterest expenses/operating revenues	52.7	45.6	46.2	45.9	48.4
Provision operating income/average assets	0.7	0.9	0.9	0.9	0.9
Core earnings/average managed assets	0.4	0.6	0.7	0.7	0.6

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

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### 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 (%)
<b>Credit risk</b>					
Government and central banks	33,641	0	0	1,009	3
Institutions and Central Counterparty	32,900	10,475	32	10,643	32
Corporate	282,528	257,575	91	246,417	87
Retail	9,569	7,738	81	5,454	57
Of which mortgage	3,715	2,063	56	1,064	29
Securitization§	0	0	0	0	0
Other assets	7,624	5,563	73	7,205	94
Total credit risk	366,262	281,350	77	270,729	74
<b>Credit valuation adjustment</b>					
Total credit valuation adjustment	--	113	--	0	--
<b>Market risk</b>					
Equity in the banking book†	5,557	5,563	100	55,570	1,000
Trading book market risk	--	69,525	--	104,288	--
Total market risk	--	75,088	--	159,858	--
<b>Operational risk</b>					
Total operational risk	--	8,575	--	14,848	--

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(Mil. NT\$)	Basel III RWA	S&P Global Ratings RWA	% of S&P Global Ratings RWA	
<b>Diversification adjustments</b>				
RWA before diversification	365,125	445,435	100	
Total Diversification/ Concentration Adjustments	--	121,919	27	
RWA after diversification	365,125	567,354	127	
(Mil. NT\$)	Tier 1 capital	Tier 1 ratio (%)	Total adjusted capital	S&P Global RAC ratio (%)
<b>Capital ratio</b>				
Capital ratio before adjustments	39,951		44,141	9.9
Capital ratio after adjustments‡	39,951		44,141	7.8

\*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 add-ons). RWA--Risk-weighted assets. RW--Risk weight. RAC--Risk-adjusted capital. NT\$--New Taiwan Dollar. Sources: Company data as of Dec. 31, 2017. 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. These weaknesses are somewhat offset by the bank's disposal of its direct investment portfolio.

O-Bank's slightly higher than average concentration on corporate lending business is mainly due to its prior wholesale business nature as an industrial bank. We expect the bank's lending portfolio to remain focused on corporates, given the bank's retail lending business is likely to be relatively small over the short term.

At the same time, we believe there are new uncertainties over the bank's retail book in terms of growth and changes to its risk exposure at the initial stage of retail banking operation. Nevertheless, we expect O-Bank's risk complexity to somewhat alleviate with its direct investment disposals.

Table 5 | [Download](#)

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

(%)	2017	2016	2015	2014	2013
Growth in customer loans	10.8	10.8	11.5	13.5	30.2
Total diversification adjustment / S&P RWA before diversification	27.4	16.2	16.5	15.3	16.2
Total managed assets/adjusted common equity (x)	12.5	11.7	11.5	10.3	9.7
New loan loss provisions/average customer loans	0.5	0.4	0.3	0.2	0.2
Net charge-offs/average customer loans	0.3	0.5	0.4	0.2	0.6
Gross nonperforming assets/customer loans + other real estate owned	0.2	0.0	0.2	0.3	0.4
Loan loss reserves/gross nonperforming assets	645.5	8,657.6	693.0	632.8	435.8

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

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### Funding and liquidity: Below average as the bank gradually develops its 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 is gradually benefitting from its commercial license, retail deposits remain a relatively small portion of its total deposit base (about 3% by the end of 2017), and the bank still primarily obtains funds through wholesale deposits. O-Bank's stable funding ratio was 95.4% as of the end of 2017, which is below the domestic average. We believe it will take time to see foundational enhancement in the bank's funding profile, given keen industry competition, O-Bank's limited branch network, as well as its strategies to maintain low funding costs over the next few years. This is despite our view that the bank could gain access to more diversified and stable funding sources along with its retail funding growth.

We view O-Bank's liquidity as adequate. Its ratio of broad liquid assets to short term wholesale funding was 1.1x at the end of 2017, indicating sufficient liquidity to cover its short term liabilities, in our view.

Table 6 | [Download](#)

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

(%)	2017	2016	2015	2014	2013
Core deposits/funding base	42.6	43.2	41.8	43.5	36.3
Customer loans (net)/customer deposits	90.8	88.1	84.8	83.7	95.4
Long term funding ratio	51.4	52.7	50.7	53.9	46.4
Stable funding ratio	95.4	99.0	98.1	101.5	92.2
Short-term wholesale funding/funding base	53.4	52.3	54.7	51.7	60.3
Broad liquid assets/short-term wholesale funding (x)	1.1	1.1	1.1	1.2	1.0
Net broad liquid assets/short-term customer deposits	12.3	15.6	16.9	24.4	8.2
Short-term wholesale funding/total wholesale funding	92.8	92.0	93.9	91.6	94.6
Narrow liquid assets/3-month wholesale funding (x)	1.0	1.0	1.0	1.1	1.0

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### Related Criteria

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology - July 20, 2017
- Understanding Taiwan Ratings' Rating Definitions, www.taiwanratings.com – June 26, 2018
- TRC Financial Services Sector Issue Credit Rating Criteria, www.taiwanraings.com - September 23, 2014
- General Criteria: Group Rating Methodology - November 19, 2013
- 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

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- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings - April 07, 2017
- Criteria - Financial Institutions - Banks: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions - January 29, 2015

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### Ratings Detail (As of July 26, 2018)

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



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