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INVESTORS SERVICE

CREDIT OPINION
11 December 2020

Update

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RATINGS

Banco Davivienda S.A.

Domicile	Colombia
Long Term CRR	Baa2
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Baa3
Type	Senior Unsecured - Fgn Curr
Outlook	Negative
Long Term Deposit	Baa3
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.

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Banco Davivienda S.A.

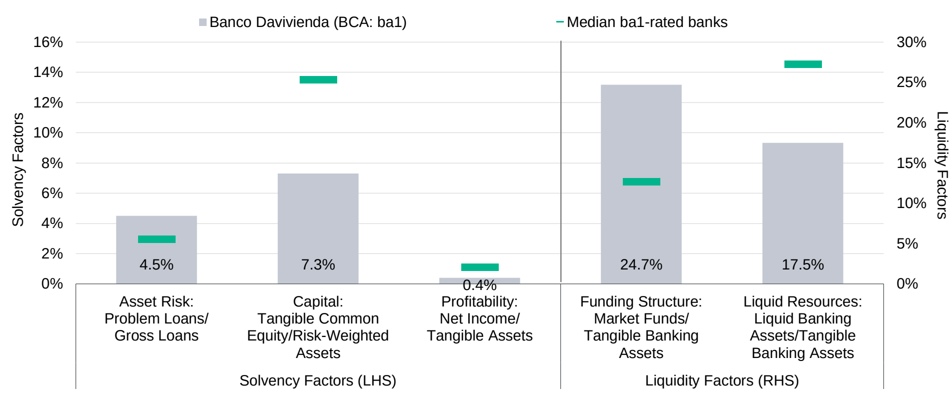
Update following rating affirmation at Baa3, outlook remains negative

Summary

Banco Davivienda S.A.'s (Davivienda) deposit ratings incorporate the bank´s Baseline Credit Assessment (BCA) of ba1, good access to core funding and stable liquidity, partially offset by the challenges to asset risk and profitability from the weak operating conditions in Colombia (Baa2 negative) because of the coronavirus pandemic. The negative outlook on Davivienda's ratings incorporates our assumption of weak operating conditions in Colombia and Central America, which could strain the bank's standalone credit strength.

On 7 December, we affirmed the Baa3 global scale deposit and debt ratings assigned to Davivienda, following the affirmation of Colombia´s sovereign debt rating of Baa2. Davivienda's deposit and senior unsecured debt ratings of Baa3 incorporate our assessment of high probability of the bank receiving government support in an event of financial stress, given its significant market share of local deposits. This assessment results in one notch of rating uplift from the bank's Adjusted BCA of ba1.

Exhibit 1
Rating Scorecard - Key financial ratios
As of September 2020



For the problem loan and profitability ratios, we review the latest three year-end ratios as well as the most recent intra-year ratio, where applicable, and base our starting point ratio on the weaker of the average of this period and the latest figure. For the capital ratio, we use the latest figure. For the funding structure and liquid asset ratios, we use the latest year-end figures.
Source: Moody's Financial Metrics

Credit strengths

» Good access to core funding and stable liquidity

Credit challenges

» Credit costs and provisioning expenses to remain high, straining profitability

» Capitalization to remain modest

» Expected deterioration in asset quality as the Colombian and Central American economies shrink in 2020 and 2021

Outlook

The negative outlook on Davivienda's ratings reflects our expectation that its asset risk, profitability and capital metrics will deteriorate further as unemployment remains high and economic activity modest into 2021.

Factors that could lead to an upgrade

While an upgrade of Davivienda's ratings is unlikely given the bank's negative outlook, the outlook could change to stable if the bank manages to halt the deterioration of its asset quality and earnings and restore its capitalization levels.

Factors that could lead to a downgrade

Davivienda's ratings could be downgraded if asset risk and profitability continue to deteriorate or the bank is unable to sustain its capitalization ratio at current levels, or both. However, the ratings would not be affected by a downgrade of Colombia's sovereign bond rating of Baa2.

Key indicators

Exhibit 2

Banco Davivienda S.A. (Consolidated Financials) [1]

	09-20[2]	12-19[2]	12-18[2]	12-17[2]	12-16[2]	CAGR/Avg.[3]
Total Assets (COP Billion)	140,438.0	122,222.0	110,723.9	100,771.3	93,548.0	11.4[4]
Total Assets (USD Million)	36,436.2	37,245.8	34,095.1	33,764.9	31,161.9	4.3[4]
Tangible Common Equity (COP Billion)	8,949.2	8,934.3	8,207.8	7,312.7	6,467.7	9.0[4]
Tangible Common Equity (USD Million)	2,321.9	2,722.6	2,527.4	2,450.2	2,154.5	2.0[4]
Problem Loans / Gross Loans (%)	4.5	3.7	4.0	2.8	1.9	3.4[5]
Tangible Common Equity / Risk Weighted Assets (%)	7.3	8.4	8.5	8.3	7.7	8.0[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	33.0	27.5	29.6	22.4	17.1	25.9[5]
Net Interest Margin (%)	5.6	5.9	5.8	5.8	5.8	5.8[5]
PPI / Average RWA (%)	4.0	4.3	4.3	4.3	4.5	4.3[6]
Net Income / Tangible Assets (%)	0.4	1.2	1.3	1.3	1.9	1.2[5]
Cost / Income Ratio (%)	47.6	45.9	46.2	46.2	45.1	46.2[5]
Market Funds / Tangible Banking Assets (%)	24.7	23.5	25.2	23.6	22.8	24.0[5]
Liquid Banking Assets / Tangible Banking Assets (%)	17.5	16.6	17.6	18.7	17.3	17.5[5]
Gross Loans / Due to Customers (%)	125.8	126.9	128.4	123.5	122.3	125.4[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel II; IFRS. [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 II periods.
Sources: Moody's Investors Service and company filings

Profile

Banco Davivienda S.A. (Davivienda), a Colombian universal bank, provides banking and other financial products and services, including deposit and savings accounts, loans, mortgages and leasing facilities to retail, microfinance, small and medium-sized enterprise (SME), corporate and commercial clients, as well as to public authorities. As of September 2020, it was the country's second-largest financial entity in terms of gross loans (with a market share of 16.5%, only considering Colombia's operations), and reported total consolidated assets of $36 billion. As of September 2020, the bank's loan portfolio in Colombia accounted for 79.4% of the total and the remaining 20.6% was international. Davivienda's international operations are in Costa Rica, El Salvador, Panama and Honduras.

Davivienda was established in 1972 as a savings and mortgage corporation named Corporación Colombiana de Ahorro y Vivienda. Its preference shares have been listed on the Colombian Stock Exchange since 2010 (ticker: PFDAVVNDA). The bank’s largest shareholder was Grupo Bolívar S.A, which owned 58.4% of its total share capital as of September 2020.

Recent developments

To reflect the growing strain from the pandemic-related disruptions, in March 2020, we changed our outlook on Latin American banking systems to negative, reflecting our view that the disruptions will exacerbate an existing slowdown in the region’s economic growth. This will increase the strain on Latin American banks’ operating environment and will erode banks’ asset quality. The authorities’ broad supplemental policy actions will support banks’ liquidity, and their adequate capitalization will help buffer stress losses. However, the recovery will likely be relatively more muted in the region than in advanced economies, in which case the credit-negative implications for banks will intensify.

Considering the growing strain of the pandemic-related disruptions, in April 2020, we changed the outlook on the Colombian banking system to negative from stable, to reflect our view that the disruption related to the pandemic and the effects of lower oil prices on economic growth expectations will increase the strain on Colombian banks’ operating environment and asset quality. Colombian banks' capital will decrease with rising loan-loss provisions, and profitability will be tempered by increasing credit costs and lower interest rates. Lower growth and more modest dividend payouts could benefit Colombian banks' modest capitalization levels.

On 3 December, we affirmed Colombia´s sovereign rating of Baa2 and changed the outlook to negative from stable. The Baa2 sovereign rating is supported by the government's track record of implementing macroeconomic policies that support the economy's capacity to withstand shocks and the adjustment that has followed these episodes. Colombia's policy response to the 2014-16 terms-of-trade shock contributed to our view before the pandemic that key credit metrics such as debt ratios and GDP growth would improve over time. The quality of macroeconomic policymaking is recognized by Colombia's qualification for a flexible credit line (FCL) with the International Monetary Fund (IMF). The FCL was increased to $17 billion in 2020 and will contribute to the funding of the government's larger financing needs while still providing supplementary coverage for balance of payment risks. The government's ability and willingness to conduct prudent policymaking will be tested by the magnitude of the pandemic's economic and fiscal shock.

Detailed credit considerations

Asset quality deteriorated in 2020 and will be strained over the next 12 months

Davivienda's asset quality has decreased since the beginning of the pandemic. The bank's nonperforming loans (NPLs), measured as Stage 3 loans under IFRS, were 4.5% as of September 2020 compared with 3.7% as of year-end 2019. The deterioration was driven by the weaker operating environment in Latin America because of the disruption caused by the pandemic. The asset risk increase is also a reflect that the first wave of deferral programs finished, reflecting a more accurate asset quality of the bank as of September 2020. After the finish of the first wave of supports the bank implemented the “ Programa de Acompañamiento a Deudores” (PAD) that will continue until December 2020.

Loan delinquencies were stable during the early stages of the outbreak because of banks' focus on providing adequate support to their most vulnerable customers through loan deferrals and government programs. However, during the third quarter of 2020, the impact on asset quality became apparent because of the difficult economic environment and lower repayment capacities of clients.

Davivienda's international credit exposures in Central America have remained at around 20% of total consolidated credit over the last few years, and their share in the bank's total consolidated problem loans improved to 11% as of year-end 2019 from 23% in 2015. The bank's operations in El Salvador and Costa Rica are its largest overseas exposures, with around 7% of total consolidated credits each, while its Honduras- and Panama-based subsidiaries account for 4%. For the 12 months that ended September 2020, the bank's consolidated gross loans rose 15%, driven by the growth in the commercial and consumer portfolios.

Its loan-loss reserves remained at an adequate 120% of Stage 3 loans as of September 2020, reflecting an increase in problem loans. However, the increase in problem loans was mitigated by an 34.8% rise in loan-loss reserves during the first nine months of 2020 in anticipation of a potential deterioration in asset quality because of credit payment deferrals and the the adverse economic scenario as the pandemic affects the bank's operating conditions in Colombia and Central America.

We expect the bank's asset quality to deteriorate further as a result of the weakening economic environment in Colombia and Central America. Davivienda´s problem loans have benefited from the deferral programs that it established to reduce the impact of the pandemic on the loan portfolio. Nevertheless, we expect the problem loans to increase during the next few months and peak in H1 2021. Colombia´s credit relief measures increase banks´ asset risks because there is a higher chance that these borrowers will default on their loans once the payment deferral scheme ends. Davivienda is more exposed than its peers to consumer and mortgage financing for low-income households and, hence, its loan book is more sensitive to economic downturns.

Capital levels will benefit from Basel III implementation and remain stable, mitigating asset risks

Our assessment for capital captures the bank's current capital position and our expectation that it will remain stable, supported by slow asset growth and limited dividend payouts throughout 2021. Davivienda had a modest tangible common equity (TCE)/risk-weighted assets (RWA) of 7.3% as of September 2020, compared with 8.4% as of year-end 2019. The nearly 110-basis-point decrease in capitalization was largely driven by weaker earnings, the increase in RWA from the growth in the loan book, the depreciation of the Colombian peso against the US dollar during 2020, and the dividend payment of COP418 billion approved in the board meeting in March 2020, implying a payout ratio of 31.8%, which is in line with the 2019 payout ratio.

We calculate TCE by deducting goodwill from common equity. We adjust RWA by risk weighting government securities at 50%, in line with the Colombian government's Baa2 bond rating. Davivienda's capital is negatively weighted by its large stock of goodwill, which is mainly related to the acquisition of Bancafé/Granbanco.

We expect the bank to preserve its capital position during 2020 and 2021 as the high growth in its portfolio slows down in light of the pandemic, and as limited dividend payments and the Basel III implementation start to take effect, lowering the density of the bank's RWA and increasing its capital ratios.

Profitability has been hurt by high credit costs and will remain strained

Davivienda's bottom-line results decreased 64% in the first nine months of 2020 compared with the year-earlier period. The decrease was largely driven by a 62% increase in provisions during the first nine months of 2020 as a result of the economic deterioration caused by the pandemic. The pre-provision income (PPI) ratio was 85% as of September 2020, compared with 55% a year earlier. Davivienda's net income/tangible assets decreased to 0.4% as of September 2020 from 1.23% as of year-end 2019.

The bank's profitability deteriorated significantly during the first nine months of 2020, but low interest rates and the economic uncertainty will strain it further in Q4 2020. We expect the bank to have positive net income in 2020 and 2021; nevertheless, its profitability will not recover to 2019 levels until 2022.

Access to core funding and reduced loan growth reduce the need to raise market funds

The ba2 score for Funding Structure incorporates the bank's moderate reliance on market funds, representing 25% of banking assets, supported by its sizable branch network — positioned among Colombia's top four networks — and good market position in Central America. It also takes into consideration the fact that funding needs will remain low in the slow-growth environment. Davivienda has a 13.8% market share in terms of deposits in the Colombian banking system.

Davivienda's presence in different markets provides it an opportunity to gather core deposits and reduce its dependence on market funds.

The bank's liquid resources remain modest, but consist of highly liquid instruments because most of them are invested in low-risk assets, mainly made up of cash, balances with the central bank and government bonds of Colombia. However, liquidity improved to 17.4% as of September 2020 from 16.6% as of September 2019.

Davivienda's ratings are supported by Colombia's weighted Macro Profile of Moderate

Davivienda's operations are mainly focused on Colombia, which represents 79.4% of its loan portfolio and whose Macro Profile is Moderate+. Colombia's Moderate+ Macro Profile reflects the country's relatively large economy, with a history of predictable policymaking, balanced against a relatively high dependence on commodities and sensitivity to trade shocks, and borrower concentration in the banking system.

Despite its high exposure to trade shocks, external vulnerabilities are limited by the country's adequate foreign-exchange buffers and access to a sizable credit line from the IMF. Moreover, the effectiveness of the government's policy response to recent commodity shocks illustrates the country's moderate institutional strength. In this regard, the actions by the Colombian government and the central bank in response to the pandemic include measures to reinforce liquidity of financial institutions, the establishment of basic guidelines for the renegotiation of terms and conditions of existing consumer and SME loans, and interest rate cuts.

In line with lower economic growth, credit growth has decelerated substantially, and the credit-to-GDP ratio remains relatively modest. While banks are mainly deposit funded, a substantial portion of these deposits are provided by institutions, leaving banks vulnerable to funding concentration risk. At the same time, high concentration in the banking system supports banks' pricing power and lending spreads.

ESG considerations

Davivienda's exposure to environmental risks is low, consistent with our general assessment for the global banking sector. See our environmental risks heat map for further information.

Overall, banks 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 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 represent further social risks. Social trends are also relevant in a number of areas, such as shifting customer preferences toward digital banking services increasing information technology cost, aging population concerns in several countries affecting demand for financial services or socially driven policy agendas translating into regulations that affect banks' revenue base. See our social risks heat map for further information.

Governance is highly relevant for Davivienda, 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 Davivienda, we do not have any particular governance concerns. The bank has not shown any governance shortfall in recent years and benefits from a strong risk management framework. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Government support considerations

There is a high likelihood of government support for Davivienda's rated wholesale deposits and senior unsecured debt. This reflects Davivienda's large market share of deposits and loans in Colombia and, hence, the material systemic consequences that would result from an unsupported failure. Davivienda's deposit rating currently benefits from a one-notch uplift from government support.

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 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 apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion if 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.

Davivienda's CR Assessment is positioned at Baa2(cr)/Prime-2(cr)

The CR Assessment is one notch above the bank's deposit rating, reflecting our view that its probability of default is lower for operating obligations than for deposits.

Counterparty Risk Ratings (CRRs)

CRRs 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.

Davivienda's CRRs are positioned at Baa2/ Prime-2

Foreign-currency debt rating

The Baa3 long-term foreign-currency debt rating of Davivienda's five-year senior debt issuance of $500 million, denominated in Colombian pesos and settled in an equivalent amount of US dollars, due 24 October 2022 (coupon of 7.5%), is based on our evaluation of high government support, leading to a one-notch uplift from the bank's ba1 standalone BCA[1].

The Ba2 foreign-currency debt rating assigned to Davivienda's 10-year subordinated debt of $500 million in foreign currency due 9 July 2022 (coupon of 5.875%) reflects one notch of subordination from the bank's ba1 standalone BCA, in line with our standard notching practices for plain vanilla subordinated debt issuances[2].

Methodology and scorecard

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 Davivienda 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	4.5%	ba1	↔	ba1	Sector concentration	Loan growth
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel II)	7.3%	b3	↔	b2	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.4%	ba3	↔	baa3	Expected trend	
Combined Solvency Score		ba3		ba2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	23.5%	ba1	↔	ba2	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	16.6%	ba2	↔	ba2	Stock of liquid assets	
Combined Liquidity Score		ba1		ba2		
Financial Profile				ba2		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Baa2		
BCA Scorecard-indicated Outcome - Range				ba1 - ba3		
Assigned BCA				ba1		
Affiliate Support notching				0		
Adjusted BCA				ba1		

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	baa3	1	Baa2	Baa2
Counterparty Risk Assessment	1	0	baa3 (cr)	1	Baa2(cr)	
Deposits	0	0	ba1	1	Baa3	Baa3
Senior unsecured bank debt	0	0	ba1	1		Baa3
Dated subordinated bank debt	-1	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 DAVIVIENDA S.A.	
Outlook	Negative
Counterparty Risk Rating	Baa2/P-2
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)
Senior Unsecured	Baa3
Subordinate	Ba2

Source: Moody's Investors Service

Endnotes

1 See our Press Release Moody's rates Banco Davivienda's proposed senior unsecured notes Baa3; stable outlook, published on 12 October 2017.

2 See our Press Release Moody's rates Davivienda's proposed subordinated debt issuance, published on 27 June 2012.

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