MOODY'S
INVESTORS SERVICE

CREDIT OPINION
6 April 2021

Update

Rate this Research

Banco Davivienda S.A.

Update following ratings affirmation, outlook changed to stable from negative

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	Stable
Long Term Deposit	Baa3
Type	LT Bank Deposits - Fgn Curr
Outlook	Stable

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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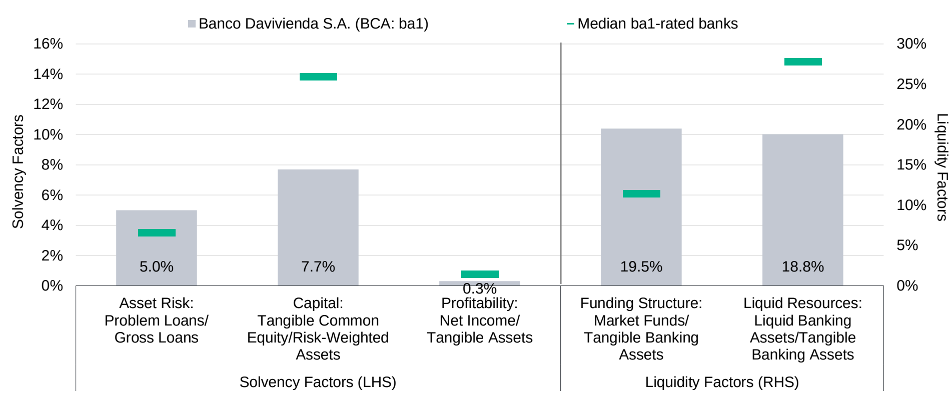
Summary

On 31 March 2021, we affirmed all ratings and assessments assigned to Banco Davivienda S.A.'s (Davivienda). The outlook on ratings was changed to stable from negative. Davivienda's baseline credit assessment (BCA) of ba1 reflects the bank's good access to core deposits and a long track record of steady, although modest, position in liquid assets. Conversely, Davivienda's ratings are challenged by problem loan ratios that have increased significantly in recent months. The stable outlook reflects our view that profitability and capital metrics will likely rise as economic activity gradually recovers.

Moody's also assigns to Davivienda global scale deposit and debt ratings of Baa3, which incorporate our assessment of high probability that the bank would receive government support from the Colombian government (Baa2, Negative) in an event of financial stress. 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 December 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

» Funding comprised mostly of core deposits reflecting bank's good market share in the system

» Profitability will likely increase if prospects of economic recovery are crystalized

Credit challenges

» Asset quality metrics will likely remain high, still as a result of negative influence from the Covid-19 pandemic in Colombia and Central American

» Provision expenses will likely remain high and hinder a stronger recovery in profitability

» Capitalization will likely remain modest, although it will benefit from Basel III implementation

Outlook

The stable outlook on Davivienda's ratings reflects our expectation that the bank's funding, profitability and capital metrics will likely improve as the recovery of economic activity in Colombia crystalizes in 2021.

Factors that could lead to an upgrade

Davivienda's ratings could be upgraded if the bank reports consistent improvement of asset quality. In addition, a sustainable strengthening in earnings generation, amid increasing loan origination, could boost the bank's capital position and have positive effect on its ratings.

Factors that could lead to a downgrade

Davivenda's ratings could be downgraded if asset risk and profitability deteriorate and/or the bank is unable to sustain capitalization at current levels. However, the ratings would not be affected by a downgrade of the Government of Colombia's sovereign bond rating of Baa2, which has a negative outlook.

Key indicators

Exhibit 2

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

	12-20[2]	12-19[2]	12-18[2]	12-17[2]	12-16[2]	CAGR/Avg.[3]
Total Assets (COP Billion)	135,162.3	122,222.0	110,723.9	100,771.3	93,548.0	9.6[4]
Total Assets (USD Million)	39,515.4	37,245.8	34,095.1	33,764.9	31,161.9	6.1[4]
Tangible Common Equity (COP Billion)	8,881.8	8,934.3	8,207.8	7,312.7	6,467.7	8.3[4]
Tangible Common Equity (USD Million)	2,596.6	2,722.6	2,527.4	2,450.2	2,154.5	4.8[4]
Problem Loans / Gross Loans (%)	5.0	3.7	4.0	2.8	1.9	3.5[5]
Tangible Common Equity / Risk Weighted Assets (%)	7.7	8.4	8.5	8.3	7.7	8.1[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	34.8	27.5	29.6	22.4	17.1	26.3[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 (%)	0.3	1.2	1.3	1.3	1.9	1.2[5]
Cost / Income Ratio (%)	46.3	45.9	46.2	46.2	45.1	45.9[5]
Market Funds / Tangible Banking Assets (%)	19.5	20.7	25.2	23.6	22.8	22.4[5]
Liquid Banking Assets / Tangible Banking Assets (%)	18.8	16.6	17.6	18.7	17.3	17.8[5]
Gross Loans / Due to Customers (%)	120.5	126.9	128.4	123.5	122.3	124.3[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

Davivienda, a 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 December 2020, the reported consolidated assets of $39.5 billion. In addition, it was the country's second-largest financial entity in terms of gross loans, with a market share of about 16% in Colombia. The bank had 81% of its loans in Colombia and the remaining 19% abroad, including 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. The bank's largest shareholder was Grupo Bolívar S.A, which owned 58.5% of its total share capital as of December 2020.

Detailed credit considerations

Problem loan volume will likely remain high in 2021

Davivienda's asset quality has weakened since the beginning of the pandemic on March 2020. The bank's nonperforming loans (NPLs), measured as Stage 3 loans under IFRS, increased to 5.0% as of December 2020, compared with 3.7% one year prior, although it still remains below ratios reported by domestic peers. The increase in NPLs was driven by the weaker operating environment in Latin America caused by the coronavirus pandemic. In addition, the weak asset quality metrics also reflect the end of regulatory measures that allowed banks to defer loan payments in 2020.

The bank's loan delinquencies were stable during the early stages of the outbreak because of Davivienda's focus on providing adequate support to their most vulnerable customers through loan deferrals. However, during the third quarter of 2020, a weaker economic environment made it harder for borrowers to repay loans and had a negative impact on Davivienda's asset quality.

Davivienda's Central America credit exposures have comprised about 20% of the bank's consolidated loan book over the last few years. Moreover, problem loans from Central Amercia accounted for 11% of the bank's total NPLs in December 2020, from 23% in December 2015. The bank's operations in El Salvador and Costa Rica are its largest exposures overseas, with around 7% of total consolidated credits each, while its Honduras and Panama-based subsidiaries account for 4%. For the 12 months that ended December 2020, the bank's consolidated gross loans rose 9.5%, 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 December 2020, reflecting an increase in problem loans. However, the increase in problem loans was mitigated by an 54.3% rise in loan loss reserves during 2020 in anticipation of a potential deterioration in asset quality because of credit payment deferrals and the adverse economic scenario as the pandemic affected the bank's operating conditions in Colombia and Central America.

We expect the bank's nonperforming loans to remain high as a result of the still-weak economic environment in Colombia and Central America. In 2020, Davivienda´s nonperforming loans benefited partially from the loan payment deferral. However, with the end of government credit relief measures, we expect borrowers' capacity to pay loans to weaken. The deferrals program will end in June 2021 in Colombia while in Central America will be through all the year. Davivienda is more exposed than its peers to consumer and mortgage financing for low-income households. As a result, its loan book is more sensitive to economic downturns.

Capital will benefit from Basel III implementation and remain steady

Our assessment for capital captures the bank's current capital position and our expectation that it will gradually increase, supported by slow asset growth; limited dividend payout in 2021; and the implementation of Basel III. Davivienda had a modest tangible common equity to risk-weighted assets ratio (TCE/RWA) of 7.7% as of December 2020, compared with 8.4% one year prior. The nearly 70-basis-point decrease in capitalization was largely driven by weaker earnings, the increase in RWA due to loan growth, the depreciation of the Colombian peso against the US dollar during 2020, and a dividend payment of COP418 billion approved in March 2020, implying a payout ratio of 31.8%, which is in line with the bank's payout ratio in 2019.

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 declined due to hurt by high provisions; but will likely improve as economic activity recovers

Davivienda's bottom-line results decreased 72.5% in December 2020 compared with the previous year. The decline in net income was largely driven by a 72% increase in loan loss provision expenses as a result of the economic deterioration caused by the pandemic. The bank's ratio of loan loss provisions to pre-provision income (PPI) climbed to 90% in December 2020, from 55% a year earlier; while its ratio of net income to tangible assets fell to 0.3% from 1.23% during the same period.

The bank's profitability declined in 2020 because of the low interest rates in the Colombian economy and the coronavirus pandemic. Nevertheless, we expect that profitability will likely improve gradually as prospects economic recovery crystalizes in 2021 and provision expenses return to more normalized levels in the next two years.

Access to core funding remains a positive, modest loan origination reduces the need for market funds

Our assessment for Funding Structure incorporates the bank's moderate reliance on market funds, representing 20% 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 about 14% 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 18.8% as of December 2020 from 16.6% as of December 2019.

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

Davivienda's operations are mainly focused on Colombia, which represents about 81% 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	5.0%	ba1	↔	ba2	Sector concentration	Loan growth
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel II)	8.4%	b1	↔	b2	Risk-weighted capitalisation	
Profitability						
Net Income / Tangible Assets	0.3%	b1	↔	baa3	Expected trend	
Combined Solvency Score		ba3		ba3		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	19.5%	baa3	↔	ba1	Extent of market funding reliance	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	18.8%	ba2	↔	ba2	Stock of liquid assets	
Combined Liquidity Score		ba1		ba1		
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	Stable
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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