MOODY'S
RATINGS

Rating Action: Moody's Ratings affirms Davivienda's Baa3 deposit ratings; maintains negative outlook

13 Jan 2025

New York, January 13, 2025 -- Moody's Ratings (Moody's) has today affirmed Banco Davivienda S.A.'s (Davivienda) long- and short-term local and foreign currency deposit ratings at Baa3 and Prime-3, respectively. We also affirmed the bank's long- and short-term local and foreign currency Counterparty Risk Ratings at Baa2 and Prime-2, respectively, and long- and short-term Counterparty Risk Assessments at Baa2(cr) and Prime-2(cr), respectively. Concurrently, we affirmed Davivienda's Baseline Credit Assessment (BCA) and Adjusted BCA at ba2. We also affirmed at B2 (hyb) the foreign currency subordinate debt rating on Davivienda's Additional Tier 1 subordinated notes. The outlook on the long-term deposit ratings remains negative.

This rating action follows the announcement Davivienda published on 6 January about its agreement with Canada-based Bank of Nova Scotia (BNS, Aa2 stable, a3) to integrate BNS's subsidiaries in Colombia, Costa Rica and Panama with Davivienda's existing operations in the three countries. The integration is subject to regulatory approval in all four jurisdictions, expected in the second half of 2025.

RATINGS RATIONALE

In affirming Davivienda's BCA at ba2, we acknowledge the bank's large and well-established commercial franchise in Colombia, in addition to its operations in Central America. The BCA of ba2, however, is challenged by the bank's net losses related to a rise in loan loss provisions and narrow margins in 2023 and the first nine months of 2024. Additionally, Davivienda's problem loan ratios remain high compared with levels reported in 2022, still reflecting a rise in consumer loan delinquencies that has affected the entire Colombian banking system since early 2023. Davivienda, nonetheless, has maintained steady efforts to improve the quality of new loan vintages, as well as of its current loan portfolio – by tightening its collection process – and to control operating expenses. The integration of BNS into Davivienda's ownership structure will also provide additional governance oversight.

We expect Davivienda to return on reporting positive profitability ahead of regulatory approvals for the integration, in line with the bank's conservative loan origination and operating cost controls. In September 2024, Davivienda's net income to tangible assets ratio was -0.19%, up slightly from -0.66% in March 2024. After the merger between Davivienda and BNS's subsidiaries begins, the new combined bank will have access to cost synergies and to a larger client base that will likely give support to a more consistent origination of recurring earnings.

Even if Banco Scotiabank Colpatria S.A., BNS's subsidiary in Colombia, remains a loss-making operation after the merger begins, this effect will be mitigated by the positive bottom-line results posted by BNS's subsidiaries in Costa Rica and Panama. Scotiabank Colpatria has faced eight consecutive quarters of net losses (Q1 2023-Q3 2024) also because of high provision expenses.

In September 2024, Davivienda's problem loan ratio, measured as stage 3 loans under IFRS to gross loans, stood at 4.90%, which was slightly lower than 4.96% one year prior. The gradual improvement in Davivienda's asset quality has been driven mostly by reduction in loan delinquency in the consumer segment. In addition, the bank continues to report the lowest problem loan ratio among its peer group of large Colombian banks. We expect the combined bank will likely benefit from the relatively lower level of problem loan ratios in BNS's subsidiaries in Costa Rica and Panama, while Scotiabank Colpatria's problem loan ratio at 5.13% in September 2024, indicates only slightly higher asset risks than at Davivienda.

Davivienda's capitalization, measured by our ratio of tangible common equity (TCE) to risk weighted assets (RWA), was 9.46% in September 2024, showing a slight improvement of 8 basis points from one year prior. At the same date, the bank's regulatory Common Equity Tier 1 (CET1) capital ratio of 10.37% offered adequate cushion over the minimum requirement of 7.0%. As a result of the merger, management expects the combined bank to have a higher CET1 ratio. Estimates calculated as of September 2024 produce a combined CET1 ratio of 10.74%, as the sum of equity would be more positive than the sum of risk-weighted assets for the new bank.

Following the merger, BNS will have a 20% ownership of Davivienda, providing it participation in its board of directors and cementing the industry best practices the bank maintains in its risk management, policies and procedures. Davivienda's shareholder ownership is dominated by Grupo Bolívar, a private group among the most important conglomerates in Colombia, with over 80 years of experience.

The bank's Baa3 long-term deposit ratings incorporate our assessment of a very high probability of support from the Government of Colombia (Colombia, Baa2 negative), which results in two notches of uplift from the bank's ba2 BCA. In our view, Davivienda would benefit from government support in an event of financial stress considering its market share in local deposits, which was 14.2% in September 2024, but would have gone up to 18.1% considering the integration of Scotiabank Colpatria's operations.

The negative outlook on Davivienda's deposit ratings of Baa3 considers the negative outlook on Colombia's sovereign rating, coupled with negative pressure on the bank's BCA stemming from net losses reported in 2023 and first half 2024 and problem loan ratios that remained at relatively high, compared with historical levels, as of September 2024.

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

Considering the negative outlook on Colombia's sovereign rating, upward rating pressure is unlikely at this time for Davivienda's ratings. However, a stabilization of the outlook on the sovereign rating could lead to a stabilization of the bank's ratings outlook. Upward pressure on the bank's BCA would stem from material and consistent improvement in asset quality and capital. In addition, a higher profitability would also be positive to the BCA, particularly as result of successful loan portfolio cleanup and of an improved ability to absorb potentially higher operating expenses related to the integration process of BNS's subsidiaries. Stronger economic growth and lower inflation in Colombia and Central America will also be beneficial to the bank's financial metrics and BCA.

The bank's deposit ratings, which benefit from government support uplift, would face negative pressure in case Colombia's sovereign debt rating were to be downgraded. Additionally, Davivienda's long-term ratings would face downward pressure if its BCA is downgraded, which could happen in case the bank reports additional net losses on a consistent basis and negative pressure on asset quality leads to higher provisioning needs, affecting earnings and capitalization. A longer-than-expected and costly integration process could also pressure profits and have a negative effect on the BCA.

The principal methodology used in these ratings was Banks published in November 2024 and available at https://ratings.moodys.com/rmc-documents/432741 . Alternatively, please see the Rating Methodologies page on https://ratings.moodys.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 on https://ratings.moodys.com/rating-definitions .

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