MOODY'S
INVESTORS SERVICE

CREDIT OPINION
21 October 2021

Update

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Banco Davivienda S.A.

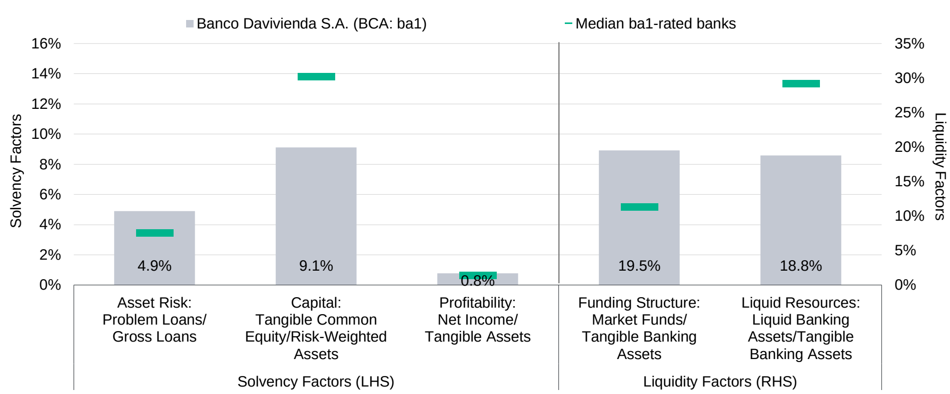
Update to credit analysis

Summary

Banco Davivienda S.A.'s (Davivienda) standalone 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 BCA is challenged by a problem loan ratio, measured as stage 3 loans to gross loans, that remains above its pre-pandemic level, despite a slight reduction from YE2020. This rise in the ratio reflected growth of the consumer loan book and the pandemic outbreak. The stable outlook reflects our view that profitability and capital metrics will likely rise as economic activity gradually recovers.

Davivienda's global scale deposit and debt ratings of Baa3 incorporate our assessment of high probability that the bank would receive support from the Colombian government (Baa2, Stable) 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 June 2021



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

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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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

» Capitalization has benefited from Basel III implementation, but will likely remain modest in the next 12-18 months

Credit challenges

» Asset quality metrics will likely remain in similar levels of June 2021, still as a result of negative influence from the Covid-19 pandemic in Colombia and in Central America

» Provision expenses will decrease from 2020 levels but likely remain higher than pre-pandemic metrics and will weigh on the recovery of profitability

Outlook

The stable outlook on Davivienda's ratings reflects our expectation that the bank's funding, profitability and capital metrics will likely improve as economic recovery crystalizes in Colombia in the next 12 to 18 months.

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 steady strengthening in earnings generation, amid increasing loan origination, could boost the bank's capital position and have positive effect on ratings.

Factors that could lead to a downgrade

Davivienda'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 if there were a downgrade of Colombia's sovereign bond rating of Baa2, which is unlikely at this time given the stable outlook on the rating.

Key indicators

Exhibit 2

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

	06-21[2]	12-20[2]	12-19[2]	12-18[2]	12-17[2]	CAGR/Avg.[3]
Total Assets (COP Billion)	140,054.5	135,162.3	122,222.0	110,723.9	100,771.3	9.9[4]
Total Assets (USD Million)	37,507.9	39,515.4	37,245.8	34,095.1	33,764.9	3.0[4]
Tangible Common Equity (COP Billion)	9,389.5	8,881.8	8,934.3	8,207.8	7,312.7	7.4[4]
Tangible Common Equity (USD Million)	2,514.6	2,596.6	2,722.6	2,527.4	2,450.2	0.7[4]
Problem Loans / Gross Loans (%)	4.9	5.0	3.7	4.0	2.8	4.1[5]
Tangible Common Equity / Risk Weighted Assets (%)	9.1	7.7	8.4	8.5	8.3	8.4[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	36.0	34.8	27.5	29.6	22.4	30.1[5]
Net Interest Margin (%)	5.4	5.6	5.9	5.8	5.8	5.7[5]
PPI / Average RWA (%)	4.8	4.0	4.3	4.3	4.3	4.4[6]
Net Income / Tangible Assets (%)	0.8	0.3	1.2	1.3	1.3	1.0[5]
Cost / Income Ratio (%)	46.9	46.3	45.9	46.2	46.2	46.3[5]
Market Funds / Tangible Banking Assets (%)	22.9	19.5	20.7	25.2	23.6	22.4[5]
Liquid Banking Assets / Tangible Banking Assets (%)	17.3	18.8	16.6	17.6	18.7	17.8[5]
Gross Loans / Due to Customers (%)	122.6	120.5	126.9	128.4	123.5	124.4[5]

[-] Further to the publication of our revised methodology in July 2021, for issuers that have “high trigger” additional Tier 1 instruments outstanding, not all ratios included in this report reflect the change in treatment of these instruments. [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 June 2021, the bank reported consolidated assets of COP140.1 billion ($37.5 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 79% of its loans in Colombia and the remaining 21% 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.

Detailed credit considerations

High volume of loan loss reserves mitigates steady high level of problem loans

Davivienda's asset quality has weakened since the beginning of the pandemic in March 2020. The bank's nonperforming loans (NPLs), measured as Stage 3 loans under IFRS, increased to 4.9% as of June 2021 compared with 3.5% one year prior. The ratio was slighty below the 5.0% reported in December 2020. Although the bank's problem loan ratio has gone up, it remains below those reported by domestic peers. Particularly, the increase in NPLs has been driven by lingering heightened asset risk driven by the coronavirus pandemic in Colombia and in countries in Central America. 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, the country's weaker economic environment made it harder for borrowers to repay loans and had a negative impact on Davivienda's asset quality.

Davivienda's Central American credit exposures have comprised about 20% of the bank's consolidated loan book over the last few years. In June 2021, problem loans from Central America accounted for 14% of the bank's total NPLs, 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 6%. In June 2021, the bank's consolidated gross loans rose 1.3% annually, driven by the growth in the mortgage portfolio, which offset the decline in the commercial segment.

Loan loss reserves remained at an adequate 105% of Stage 3 loans as of June 2021. They will be an important mitigant to asset risk during the second half of the year. The increase in problem loans since the pandemic outbreak was partially offset by a 54.3% rise in loan loss reserves during 2020, as the bank anticipated a potential deterioration in asset quality. This weakening was temporarily postponed by credit payment deferrals. However, NPLs went up due to the adverse economic scenario as the pandemic affected Davivienda's operations in Colombia and Central America.

In the next 12 months, bank's NPLs will likely in line with levels reported June 2021 as a result of the still-recovering economic activity in Colombia and Central America. Loans under the Debtors Support Program represented 9% of the portfolio in both Colombia and Central America, of which just 4% and 3% were delinquent loans, respectively as of June 2021. 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 than other big banks in Colombia.

Capital remains steady, added by lower loan growth relative to previous years

Our assessment for capital reflects our view that a slow asset growth relative to pre-pandemic years and more modest dividend payout in 2021 will keep the bank's capital ratio stable during the second half of 2021.

Moody's preferred ratio of tangible common equity to risk-weighted assets (TCE/RWA) for Davivienda increased to 9.12% in June 2021, relative to 7.23% one year prior. The 189-basis point increase in capitalization was driven largely by lower RWAs following the implementation of the Basel III framework in January 2021, as well as by higher earnings and lower loan growth than pre-pandemic levels. In addition, during the first six months of 2021 the bank did not make any dividend payment. On a regulatory basis, the implementation of the Basel III framework yielded a positive impact of more than 350 basis points to Davivienda's total capital 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 affected negatively by a large stock of goodwill, which is mainly related to the acquisition of Bancafé/Granbanco.

Profitability has improved, but remains below its level in 2019

Davivienda's bottom-line results increased 54.1% in the first six months of 2021 compared with the same period one year earlier. The increase in net income was largely driven by higher earnings from foreign exchange operations and fee income. Davivienda reported an increase of 28% in fee income relative to one year prior, partially reflecting the ongoing recovery in economic activity in Colombia. As a result, Davivienda's ratio of net income to tangible assets increased to 0.8% in June 2021, from 0.5% one year prior.

The bank's ratio of loan loss provisions to pre-provision income (PPI) declined to 72% in June 2021, from 81% a year earlier. Overall, the volume of loan loss provisions decreased 1.5% in the first half of 2021 compared with June 2020, although the bank still maintains a conservative approach to asset quality by keeping high reserve coverage of problem loans. The bank´s efficiency metrics have remained in line with pre-pandemic levels as the bank benefits by its strong digitalization strategy.

Although profitability metrics have improved modestly, they will likely not recover to pre-pandemic levels in 2021, mainly as a result of the still-low interest rates and economic uncertainty in Colombia.

Volume of core funding and liquid assets remains high

Our assessment for Funding Structure incorporates the bank’s moderate reliance on market funds, representing 23% 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 13% 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. Liquidity decreased to 17.3% as of June 2021 from 19.1% as of June 2020.

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

Davivienda's operations are mainly focused on Colombia, which represents about 79% 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

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

The CR Assessment is one notch above the bank's deposit rating of Baa3, reflecting our view that its probability of default is lower for operating obligations than for deposits.

Counterparty Risk Ratings (CRRs)

Davivienda's CRRs are Baa2/ Prime-2

Davivienda's global CRRs are positioned at Baa2 and Not Prime, one notch above the bank's deposit rating of Baa3, reflecting the lower probability of default of CRR liabilities and our expectation of a normal level of loss given default.

Foreign-currency debt rating

The B1 (hyb) foreign-currency subordinated debt rating assigned to Davivienda's additional tier 1 capital notes is positioned three notches below the bank's ba1 adjusted baseline credit assessment (adjusted BCA), in line with Moody's standard notching guidance for contractual non-viability perpetual maturity securities[1].

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[2].

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[3].

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	4.9%	ba1	↔	ba2	Sector concentration	Loan growth
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	9.1%	ba3	↔	b2		
Profitability						
Net Income / Tangible Assets	0.8%	ba1	↔	baa3	Expected trend	
Combined Solvency Score		ba2		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

[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	B1 (hyb)

Source: Moody's Investors Service

Endnotes

1 See our Press Release Moody's rates B1(hyb) Davivienda's proposed additional tier 1 capital notes, published on 12 April 2021.

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

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

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