

Global Credit Research - 09 Apr 2015

Bogota, Colombia

## Ratings

Category	Moody's Rating
Outlook	Rating(s) Under Review
Bank Deposits -Fgn Curr	Baa2/P-2
Bank Deposits -Dom Curr	*Baa1/P-2
Baseline Credit Assessment	**baa2
Adjusted Baseline Credit Assessment	**baa2
Senior Unsecured	**Baa1
Subordinate	Baa3
<b>Parent: Grupo Aval Acciones y Valores S.A.</b>	
Outlook	Rating(s) Under Review
Issuer Rating	**Baa3
ST Issuer Rating	**P-3
<b>BAC International Bank, Inc</b>	
Outlook	Stable
Bank Deposits	Baa3/P-3
Baseline Credit Assessment	baa3
Adjusted Baseline Credit Assessment	baa3

\* Rating(s) within this class was/were placed on review on March 17, 2015

\*\* Placed under review for possible downgrade on March 17, 2015

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## Key Indicators

### Banco de Bogota S.A. (Consolidated Financials)[1]

	[2]9-14	[2]12-13	[2]12-12	[2]12-11	[2]12-10	Avg.
Total Assets (COP billion)	111,763.6	100,669.0	80,506.4	68,809.6	59,346.6	[3]17.1
Total Assets (USD million)	55,365.4	52,106.3	45,561.0	35,496.1	30,909.5	[3]15.7
Tangible Common Equity (COP billion)	5,217.1	5,075.2	4,573.5	3,539.4	761.2	[3]61.8
Tangible Common Equity (USD million)	2,584.4	2,626.9	2,588.3	1,825.8	396.5	[3]59.8
Problem Loans / Gross Loans (%)	1.4	1.3	1.2	1.3	1.6	[4]1.4
Tangible Common Equity / Risk Weighted Assets (%)	5.5	5.7	6.3	5.6	1.4	[5]4.9
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	13.1	11.5	9.6	11.6	30.2	[4]15.2

Net Interest Margin (%)	4.7	5.1	5.3	4.0	3.4 [4]4.5
PPI / Average RWA (%)	4.0	4.5	4.2	5.1	6.9 [5]4.9
Net Income / Tangible Assets (%)	1.8	1.4	1.7	1.7	1.6 [4]1.7
Cost / Income Ratio (%)	52.6	58.6	60.2	55.9	43.4 [4]54.1
Market Funds / Tangible Banking Assets (%)	19.3	17.1	17.8	16.9	17.1 [4]17.6
Liquid Banking Assets / Tangible Banking Assets (%)	30.8	31.6	33.5	30.7	31.7 [4]31.7
Gross Loans / Total Deposits (%)	77.7	77.1	75.7	78.3	74.3 [4]76.6

Source: Moody's

[1] All figures and ratios are adjusted using Moody's standard adjustments [2] Basel I; LOCAL GAAP [3] Compound Annual Growth Rate based on LOCAL GAAP reporting periods [4] LOCAL GAAP reporting periods have been used for average calculation [5] Basel I & LOCAL GAAP reporting periods have been used for average calculation

## Opinion

### SUMMARY RATING RATIONALE

On 17 March 2015, Moody's placed on review for downgrade Banco de Bogotá S.A.'s baa2 standalone baseline credit assessment (BCA), Baa1 long-term local currency deposit rating, Baa1 long-term foreign currency senior unsecured debt rating and Baa3 long-term foreign currency subordinated debt rating. Banco de Bogotá's ratings are based on its baa2 baseline credit assessment (BCA) and one notch uplift from Moody's assessment of very high government support for the bank.

The review for downgrade on Banco de Bogotá's baa2 standalone BCA and Baa3 long-term foreign currency subordinated debt rating reflect Moody's new methodology's higher focus on capitalization and the constraints imposed on the bank's financial strength related its more challenging operating environment in Central America, when compared to that of Colombia alone. Banco de Bogotá's low capitalization and exposure to weaker operating environments in Central America versus that of Colombia, suggest that Moody's would adjust Banco de Bogotá's standalone BCA downwards.

The review for downgrade on Banco de Bogotá's supported ratings reflects a change in Moody's bank rating methodology affecting the way we assess the capacity of a government to provide support to a bank in the event of stress. While Banco de Bogotá's ratings will continue to benefit from systemic support uplift, we previously captured the extensive policy tools available to governments to support domestic banks, such as the provision of liquidity or regulatory forbearance, by positioning the capacity of a government above its sovereign rating. However, experience has revealed that when a crisis is prolonged, these measures are insufficient to bring back confidence to a system and an outright recapitalization of banks is necessary. The new methodology aligns the capacity of the Colombian government's support for its most important banks to the Baa2 Colombian sovereign rating. As such, we expect the outcome of the review to align more closely Banco de Bogotá's ratings with those of the Colombian government, as this rating better captures the Colombian government's fiscal limitations and, therefore, its capacity to support Banco de Bogotá. Consistent with this methodological change, the same rating action is being taken on all banks whose ratings are currently above their own government's ratings because of government support.

### BANCO DE BOGOTÁ'S RATING IS CONSTRAINED BY A WEIGHTED MACRO PROFILE OF MODERATE

Banco de Bogotá's macro profile is Moderate, weighted by the bank's loan exposures. Colombia's macro profile is Moderate+ and represents almost 70% of the bank's loan book, while its remaining operations are focused in Central America, whose weighted macro profile is Weak+. Central American exposures include Costa Rica (macro profile of Moderate-), Panama (Moderate) and Guatemala (Weak+), as well as El Salvador, Honduras and Nicaragua.

Colombia has a robust growth outlook, supported by strong domestic demand, though tempered by the country's low GDP per capita and high inequality. Despite average indicators for government effectiveness, the country benefits from a favorable investment climate and policy predictability. However, Colombia faces event risk related to its dependence on oil exports as well as ongoing problems with armed insurgencies, which have mounted an increasing number of attacks on its oil pipelines in recent years. Peace negotiations are progressing, albeit slowly.

While Central America provides Banco de Bogotá with ample geographic diversification to several countries with

high GDP growth, it also exposes Banco de Bogotá to countries with higher poverty and inequality indicators, coupled with low economic and institutional strength.

### **Rating Drivers**

Low capitalization

Central American franchise exposes the bank to more challenging operating environments

Proactive and institutionalized risk management policies ensure low levels of problem loans

Resilient levels of returns underscored by ample margins and an efficient cost structure

Core deposit funding and ample liquidity

### **Rating Outlook**

On 17 March 2015, Moody's placed on review for downgrade Banco de Bogotá's baa2 standalone BCA, Baa1 long-term local currency deposit rating, Baa1 long-term foreign currency senior unsecured debt rating and Baa3 long-term foreign currency subordinated debt rating.

Banco de Bogotá's Baa2 long-term foreign currency deposit rating and Prime-2 short-term local and foreign currency deposit ratings continue to have a stable outlook.

### **What Could Change the Rating - Down**

After the review is completed, Banco de Bogotá's baa2 standalone BCA could be lowered by one notch in line with the bank's capitalization and loss absorption capacity, which stands today amongst the lowest of the Colombian banking system and the region. The Baa3 long-term foreign currency subordinated debt rating could also be downgraded, in line with the standard one notching down from standalone BCA applied to plain vanilla subordinated debts.

The announcement of another major acquisition would prompt further reassessments of the bank's BCA.

### **What Could Change the Rating - Up**

Positive pressure on the bank's ratings could develop following a broad capitalization of the bank or a higher rating for the Colombian government (Baa2 stable), which Moody's uses to incorporate its assessment of government support.

## **DETAILED RATING CONSIDERATIONS**

### **LOW CAPITALIZATION**

Banco de Bogotá's tangible common equity (TCE, common stock plus retained earnings minus goodwill) is low due to high holdings of goodwill. While as of September 2014, the bank's common equity is a high COP9.3 trillion versus RWAs of COP96.4 trillion, goodwill represents a high COP4.1 trillion, mainly related to the acquisitions of

- 1) BAC Credomatic (BAC International Bank, Inc. Baa3 stable) from GE (COP1.9 trillion) in 2010,
- 2) Banco BAC de Panamá from BBVA (COP630 million) in 2013,
- 3) Grupo Financiero Reformador (COP548 million) in 2013,
- 4) MegaBanco from the government (COP448 million) in 2005, and
- 5) AFP Horizonte from BBVA (COP427 million) in 2013.

The bank could have access to capital as part of a much wider and well-respected financial conglomerate, Grupo Aval Acciones y Valores S.A. (Grupo Aval, Baa3 on review down), and Colombia's relatively deep pension fund managers, which provide deep liquidity for Colombia's best issuers. Grupo Aval has raised upwards of COP5 trillion in the last two years, COP2.4 trillion from its shareholders and COP2.6 trillion in the NYSE Euronext, of which 56% was down-streamed to Banco de Bogotá.

Banco de Bogotá's TCE to risk weighted assets (RWA) was a low 5.5% as of September 2014. When incorporating the November 2014 COP1.5 trillion capitalization, the bank's TCE/RWA increases substantially to about 7%, though still among the lowest of regional peers.

The bank's Tier 1 ratio is also low, even after adjustments. The difference between the unadjusted Tier 1 ratio of 7.6% and the fully adjusted Tier 1 ratio of 6.9% are related to the following Moody's adjustments:

- (a) deduction of grandfathered BAC Credomatic goodwill (goodwill after 2012 is already deducted),
- (b) risk-weighting government securities at 50%, in line with the Colombian government's bond rating (Baa2 stable), and
- (c) incorporation of retained earnings, considering Banco de Bogotá's usual payout ratio of 50%, which according to Colombian regulation are included only in Tier 2.

Stringent regulatory deduction of related minority interest has a strong effect on Tier 1 ratio. Although Banco de Bogotá only has a 38.2% ownership of Corporación Financiera Colombiana S.A. (Corficolombiana, unrated) and a 46.9% ownership of AFP Porvenir S.A. (unrated), these are nevertheless consolidated and have high capitalization. Banco de Bogotá consolidates them because the remaining majority ownership of these entities is held by related parties, namely those entities belonging to the bank's holding company, Grupo Aval. As such, Banco de Bogotá must deduct the minority interest in both entities held by related parties from its consolidated Tier 1 capital.

Going forward the related minority interest deduction could be minimized by new regulation which allows Banco de Bogotá to not have to make these deductions fully if its related parties decide to deduct the minority interest themselves.

Banco de Bogotá nevertheless has somewhat of a substantial cushion against local regulatory minima. Its unadjusted, reported Tier 1 ratio of 7.6% has a cushion of more than 300 basis points versus the regulatory minimum of 4.5%. However, the bank's total capital ratio of 11.1% has a cushion of only 200 basis points.

#### CENTRAL AMERICAN FRANCHISE EXPOSES THE BANK TO MORE CHALLENGING OPERATING ENVIRONMENTS

Banco de Bogotá has market presence in Colombia and Central America, a macroregion of a GDP of USD576 billion (2013), where it is the second largest bank. The bank's operations are mainly in its home market of Colombia (66% of gross loans), but with substantial presence in Panama (9%), Costa Rica (9%), Guatemala (6%), El Salvador (4%), Honduras (4%) and Nicaragua (3%), as well as a small credit card book in Mexico, as of September 2014. The credit ratings of some of these countries are nevertheless well below Colombia's Baa2, limiting the geographic diversification benefits.

Founded in 1870, Banco de Bogotá is the oldest bank in Colombia and has a large footprint of 1,467 branches and 3,286 ATMs in Colombia and Central America, as of September 2014.

The bank is majority owned by Grupo Aval, which in turn is owned and controlled by Dr. Luis Carlos Sarmiento Angulo. Grupo Aval has extensive and dominant holdings in the Colombian banking system, whereby smaller corporations are targeted by Banco de Occidente, payroll-linked consumer loans and subsovereign financing are targeted by Banco Popular and consumer and mortgages targeted by Banco AV Villas. Grupo Aval banks represent about a third of the Colombian banking system, as of September 2014. Grupo Aval acts as a second line of risk management for its different banks and seeks to enhance synergies and technology use, and provides services to each bank at cost.

#### RESILIENT LEVELS OF RETURNS UNDERSCORED BY AMPLE MARGINS AND AN EFFICIENT COST STRUCTURE

Banco de Bogotá's stable generation of core earnings results from an ample net interest margin (4.7% as of September 2014) related to a low cost funding base and a growing and diversified loan portfolio, both closely referenced to the benchmark interest rate and the 90-day CDT rate (DTF).

Banco de Bogotá has also successfully integrated BAC, with further beneficial effects on core earnings and their predictability, based on the business diversification that BAC's retail business brings to the bank's portfolio.

The bank also runs an efficient operation, with a cost/income ratio of 52.6% as of September 2014, down from its

three year-end average of 58.2%. This can be explained mainly by the bank's ability to generate stable earnings, underscored by its core funding profile and cost sharing benefits related to the Grupo Aval network.

The bank's profitability is ample and largely in line with that reported prior to acquisitions with net income to tangible banking assets of 1.8%, as of September 2014, versus the previous three-year end average of 1.6%.

During the first nine months of 2014, Banco de Bogotá reported consolidated net income of COP1.5 trillion, down 2.8% from the same period a year earlier, versus an important 24.8% expansion of its portfolio during that same time period as a result of acquisitions. While the bank's net interest income did expand at a more substantial pace of 10.6% to COP3.3 trillion, provisioning costs expanded faster at 19.6%, though positively at a slower pace than its portfolio.

#### PROACTIVE AND INSTITUTIONALIZED RISK MANAGEMENT

Banco de Bogotá's conservative management and credit policies have resulted in healthy asset quality indicators and delinquency ratios that have traditionally been among the region's lowest. As of September 2014, the bank's 90+ days past due loans as percentage of gross loans of 1.4%.

Banco de Bogotá also has a diversified loan book with 66% of its loans directed to corporate loans and leases, followed by personal loans with 12%, residential mortgages with 10%, credit cards with 9% and car loans with 3%, as of September 2014 (excludes loans to employees).

Banco de Bogotá's portfolio nevertheless has high concentrations, measured as top 20 exposures against tangible common equity of 1.7x, which could expose the bank to potentially rapid asset quality deterioration, but from very low levels of past due loans.

Banco de Bogotá is ultimately family-owned, which increases Moody's evaluation of the bank's risk profile. However, no major issues in terms of corporate governance have been observed in the bank. The bank's related party loans represent 10.6% of fully adjusted Tier 1 capital, as of September 2014.

#### CORE DEPOSIT FUNDING AND AMPLE LIQUIDITY

Because of its ample core deposit base in all the markets in which it operates, Banco de Bogotá does not rely on either interbank or capital markets funding.

Most of Banco de Bogotá's funding is sourced from customers with deep relations with the bank, in the form of deposits in local currencies, limiting its sensitivity to contagion risks in times of stress or to a negative shift in market sentiment in the event of a sovereign crisis. Banco de Bogotá's deposit-based funding is also diversified between Colombia and Central America. Deposits represent 70% of total funding and 117% of average gross loans, as of September 2014.

The bank's market funds are also well diversified between interbank funding (49%), repos (19%), foreign and local issuances (19%), credit card receivable-backed funding (10%) and development bank funding that the bank is required to on-lend (5%), as of September 2014.

The bank also maintains ample liquid assets diversified between cash and cash equivalents, Colombian government securities which are rated Baa2 and Central American government securities, which are rated on average Ba1 in local currency. Liquid assets represent 30.0% of total assets as of September 2014.

#### Notching Considerations

In the absence of a bail-in resolution regime framework in Colombia, as per the "Global Banks" Methodology, under "Guidelines for Rating Junior Bank Obligations", updated in July 2014, we take into account the key features of the bank's outstanding notes. As 'plain vanilla' subordinated debts with no skip mechanisms, these instruments commonly absorb losses only in a liquidation scenario. In those cases, the notching approach for 'plain vanilla' subordinated debt is one notch of subordination risk off the bank's adjusted baseline credit assessment (BCA) of the issuer.

#### Government Support

We believe there is a very high likelihood of government support for Banco de Bogotá's rated wholesale deposits and senior unsecured debt. This reflects Banco de Bogotá's large market share of deposits in Colombia and hence the material systemic consequences that would result from an unsupported failure. Banco de Bogotá's

deposit rating benefits from one notch uplift from government support, at this instance.

#### 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 Factors

#### Banco de Bogota S.A.

<b>Macro Factors</b>	
<b>Weighted Macro Profile</b>	<b>Moderate</b>

<b>Financial Profile</b>						
<b>Factor</b>	<b>Historic Ratio</b>	<b>Macro Adjusted Score</b>	<b>Credit Trend</b>	<b>Assigned Score</b>	<b>Key driver #1</b>	<b>Key driver #2</b>
<b>Solvency</b>						
<b>Asset Risk</b>						
<i>Problem Loans / Gross Loans</i>	1.4%	baa1	← →	baa1	Collateral and provisioning coverage	Geographical diversification
<b>Capital</b>						
<i>TCE / RWA</i>	5.5%	caa2	↑ ↑	b3	Access to capital	
<b>Profitability</b>						
<i>Net Income / Tangible Assets</i>	1.7%	baa1	← →	baa1	Earnings quality	
<b>Combined Solvency Score</b>		ba2		ba1		
<b>Liquidity</b>						
<b>Funding Structure</b>						
<i>Market Funds / Tangible Banking Assets</i>	17.1%	baa3	← →	baa2	Deposit quality	
<b>Liquid Resources</b>						
<i>Liquid Banking Assets / Tangible Banking Assets</i>	31.6%	baa2	← →	baa2	Quality of liquid assets	
<b>Combined Liquidity Score</b>		baa3		baa2		

#### Financial Profile

**baa3**

#### Qualitative Adjustments

#### Adjustment

Business  
Diversification  
Opacity and  
Complexity  
Corporate Behavior

0

0

0

#### Total Qualitative Adjustments

**0**

Sovereign or Affiliate constraint	Baa2
Scorecard Calculated BCA range	baa2 - ba1
Assigned BCA	baa2 Possible Downgrade
Affiliate Support notching	0
Adjusted BCA	baa2 Possible Downgrade

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating
Deposits	--	--	--	--	Baa1 RUR Possible Downgrade	Baa2
Senior unsecured bank debt	--	--	--	--		Baa1 RUR Possible Downgrade
Dated subordinated bank debt	--	--	--	--		Baa3 RUR Possible Downgrade

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