MOODY'S INVESTORS SERVICE

CREDIT OPINION
6 November 2020

Update

Rate this Research

RATINGS

BAC International Bank, Inc

Domicile	PANAMA CITY, Panama
Long Term CRR	Baa3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	Ba1
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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BAC International Bank, Inc

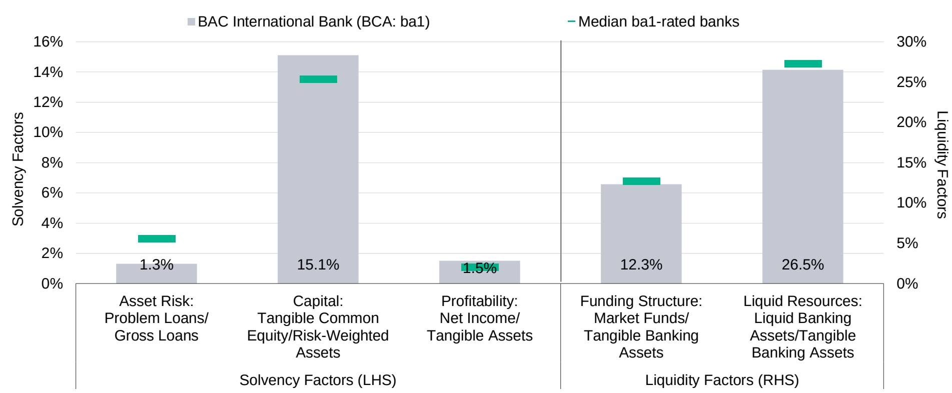
Update to credit analysis

Summary

BAC International Bank, Inc (BAC)'s ba1 standalone Baseline Credit Assessment (BCA), as well as its Ba1 long-term local and foreign currency deposit ratings reflect the bank's strong financial fundamentals, which are partially offset by the weak operating conditions in the countries where the bank operates. The bank benefits from solid and recurring earnings supported by ample interest margins, sufficient capital buffers and a sound funding profile. The ratings also incorporate the bank's relatively low loan delinquencies despite its focus on higher-risk retail segments. Although the bank's asset quality metrics improved in the first half of 2020, our assessment of BAC incorporates a potential deterioration in asset quality driven by the significant contraction of the Central American economies as a result of the coronavirus pandemic.

BAC continues to be rated significantly above most of the sovereign ratings of the countries where it operates, as 57% of the bank's loan portfolio is located at B-rated countries (Costa Rica, Honduras, El Salvador and Nicaragua). BAC's sizeable exposure to Panama (Baa1 negative) and to a lesser extent Guatemala (Ba1 stable), the benefits from its geographical and business diversification, and its continued strong financial performance continues to support the bank's ratings.

Exhibit 1
Rating Scorecard - Key financial ratios



Source: Moody's Financial Metrics

Credit strengths

» Robust profitability on the back of ample margins and healthy fee income

» Sufficient capitalization

» Wide deposit base amid good liquidity buffers

Credit challenges

» Increasing asset risks due to the pandemic outbreak

» Weak+ weighted average Macro Profile, which constrains the bank's ratings

Outlook

The outlook on BAC's ratings is stable as we expect the bank to maintain its fundamental strengths despite the challenging scenario.

Factors that could lead to an upgrade

The rating could be upgraded if there were a material and sustained improvement in the operating conditions of BAC's main countries of operation, provided that the bank sustains its solid financial performance.

Factors that could lead to a downgrade

The ratings could be downgraded if there were a deterioration in the bank's operating environment, leading the bank's asset quality to sustained deterioration and if its profitability and capitalization declined significantly.

Key indicators

Exhibit 2

BAC International Bank, Inc (Consolidated Financials) [1]

	06-20[2]	12-19[2]	12-18[2]	12-17[2]	12-16[2]	CAGR/Avg.[3]
Total Assets (USD Million)	25,416.0	23,965.1	22,751.7	22,018.1	20,047.6	7.0[4]
Tangible Common Equity (USD Million)	2,973.6	2,467.4	2,318.3	2,255.3	1,986.3	12.2[4]
Problem Loans / Gross Loans (%)	1.1	1.5	1.3	1.2	1.2	1.3[5]
Tangible Common Equity / Risk Weighted Assets (%)	15.1	12.4	12.7	12.7	12.5	13.1[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	5.2	8.6	7.7	7.4	7.7	7.3[5]
Net Interest Margin (%)	--	5.8	5.7	5.8	5.9	5.8[5]
PPI / Average RWA (%)	--	5.0	5.3	5.1	4.8	5.1[6]
Net Income / Tangible Assets (%)	1.5	1.7	1.8	1.7	1.8	1.7[5]
Cost / Income Ratio (%)	55.6	56.2	54.3	55.2	57.5	55.7[5]
Market Funds / Tangible Banking Assets (%)	11.4	12.3	15.9	16.8	19.0	15.1[5]
Liquid Banking Assets / Tangible Banking Assets (%)	30.5	26.5	26.4	25.9	24.0	26.6[5]
Gross Loans / Due to Customers (%)	88.9	97.4	102.7	103.0	108.1	100.0[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel III - fully loaded or transitional phase-in; 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 III periods.

Sources: Moody's Investors Service and company filings

Profile

BAC International Bank, Inc (BAC) is the largest bank in Central America. It provides banking services in Costa Rica (28% of total loans), Panama (24%), Guatemala (20%), Honduras (12%), El Salvador (11%) and Nicaragua (5%). The bank is principally focused on retail banking and reported total assets of around $25.4 billion as of June 2020. BAC is controlled by Colombia's Banco de Bogotá S.A. (Baa2 negative, BCA ba1).

Recent developments

The global spread of the coronavirus has resulted in simultaneous supply and demand shocks, which have materially slowed economic activity in the first half of this year. An economic recovery is already underway, but its continuation will be closely tied to containment of the virus. The macroeconomic outlook for emerging market countries is more uncertain than that for advanced economies, and the strength of economic fundamentals and vulnerabilities vary widely within these countries. High-frequency data on many countries suggest that the quarter finished in June on a much stronger note, and therefore the rebound will likely be quite strong in Q3.

A number of interrelated developments could threaten the ongoing recovery. These include: (1) a renewed worsening of the pandemic that results in the reimposition of nationwide lockdown measures; (2) prolonged stagnation if the coronavirus shock turns into a balance-sheet recession, especially in emerging market countries; (3) a spillover to the financial sector, which could further exacerbate the economic crisis; and (4) intensified trade tensions and geopolitical instability.

Detailed credit considerations

Consistently low delinquencies, although asset risk rise amid the pandemic outbreak

BAC's consolidated nonperforming loan (NPL) ratio has remained relatively low in recent years, fluctuating between 1.1% and 1.5% since 2014, which is below peers in almost all countries where the bank operates. The bank has been able to maintain delinquencies low despite the challenging operating conditions in some of the countries where it operates -mainly Costa Rica and Nicaragua- and also despite its relatively high risk appetite given its retail focus (retail loans represent about 55% of the bank's loan book as of June 2020). BAC's strong asset-quality metrics reflect management's deep knowledge of the bank's markets and the proactive treatment of problem loans.

The bank's NPL ratio reached a minimum of 1.1% in June 2020. However, similar to peers in the region, BAC's lending activities were strongly influenced by deferral programs in H1 2020 that helped reduce the pandemic's short-term impact on the loan portfolio. We expect asset quality to weaken in H2 2020 and into Q1 2021 as payment holidays come to a close. The bank has increased its loan loss reserves in order to face the expected deterioration in asset quality, with reserves coverage of problem loans reaching an ample 288% as of June 2020.

Robust profitability on the back of sufficient margins and healthy fee income, offsetting higher credit costs

Higher credit costs driven by the deterioration in asset quality have affected BAC's profitability, but it has continued to report robust earnings, with an annualized return on tangible assets of 1.5% as of June 2020 compared to a 1.7% in June 2019. We expect BAC's profitability to remain pressured in the short term, mainly as a result of higher provisions ahead of expected deterioration in asset quality. However, BAC's core earnings continue to be supported by its ample interest margins, which fell only slightly to 5.5% in H1 2020 compared to 5.7% in 2019, driven by the bank's primary lending focus on credit cards and other consumer credit.

BAC managed to contain growth in its operating expense at 2% compared with that a year earlier, keeping the cost-to-income ratio relatively stable at a manageable level of 56%. BAC has been investing to enhance its electronic distribution channels, which should support the bank's market share and allow it to streamline its cost structure.

Sufficient capitalization

The robust earnings stream has continued to support BAC's good capitalization. The bank's tangible common equity ratio has remained at an average of 12.6% between 2016 and 2019, and has increased to 15.1% as of June 2020. The recent increase was driven by the issuance on May 2020 of a $520 million high-trigger additional tier 1 (AT1) instrument, which was 100% subscribed by the bank's ultimate parent Grupo Aval. The AT1 issuance offset the impact in the bank's capital of the extraordinarily high dividend payments in 2019 and 1H 2020, which total was $807 million. As a result, BAC's common equity tier 1 ratio fell to 9.6% as of June 2020 from 11.5% as of 2019 year end, offset in the TCE calculation by the aforementioned AT1 issuance.

All BAC's operating subsidiaries are subject to and do comply with higher minimum total capital requirements than the 8% minimum applied to BAC as per Panamanian regulations. However, we expect regulators in each particular country to likely prevent capital transfers among subsidiaries to maintain stability within their respective banking systems.

Stable funding structure and good liquidity buffers

BAC is funded by a broad base of customer deposits, consistent with its well-established banking franchise in the region, which significantly reduces refinancing and repricing risks. As a result, market funding needs remain contained at around 13% of total assets. This, combined with adequate liquidity buffers at 30% of the balance sheet as of June 2020, further supports BAC's financial flexibility.

Around 74% of the bank's assets are funded with deposits, with about 24% of that amount being sourced from individuals. As a result, market funding remains contained at around 13% of total assets. As was the case with the entire banking system, BAC's deposits in Nicaragua fell sharply following the political and social crisis that started in 2018, although this situation has stabilized since mid-2019. The bank managed to absorb the impact by increasing its borrowings from international correspondent lenders and by maintaining strong liquidity buffers.

BAC sufficient liquidity buffers reflect high liquidity reserve requirements in the countries where it operates, given the absence of a lender of last resort in its main markets. Liquid resources comprise cash, dues from banks, government debt, corporate debt and equity securities.

BAC's ratings are constrained by Central America's Weak+ weighted average Macro Profile

BAC's Macro Profile is derived from a blended score, reflecting the composition of its loan portfolio as a bank operating in countries with Moderate to Weak Macro Profile scores: Panama (Moderate), Costa Rica (Weak+), Guatemala (Weak), El Salvador (Weak), Honduras and Nicaragua. The overall Weak+ Macro Profile largely reflects the region's relatively small economies, with low GDP per capita, developing institutions and lack of true lenders of last resort, which increase its susceptibility to event risks. The Macro Profile is balanced by positive economic and institutional trends during the past decade, as well as strengthening bank regulatory frameworks.

Environmental, social and governance considerations

BAC'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.

BAC's exposure to social risks is moderate, consistent with our general assessment for the global banking sector. 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 is partly 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 is a further social risk. 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 that may translate into regulations that affect banks' revenue base. See our Social risks heat map for further information.

Governance is highly relevant for BAC, as it is to all participants in the banking industry. Governance risks are largely internal rather than externally driven and remain a key credit consideration that requires ongoing monitoring, as corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit a bank's credit profile. We do not have any particular governance concerns for BAC, as it shows an appropriate risk management framework commensurate with its risk appetite.

Support and structural considerations

Affiliate support

Moody's assumes a very high probability of affiliate support to BAC from Banco de Bogotá S.A. in the case of need. This assumption is based on BAC's relevance in Banco de Bogotá S.A.'s regional footprint and earnings generation, illustrated by the bank's significant contribution to the parent's profitability. However, BAC derives no rating uplift from affiliate support because Banco de Bogotá S.A.'s ba1 adjusted BCA is already at the level of BAC's BCA.

Government support

We do not incorporate government support in BAC's deposit ratings, given the lack of a true lender of last resort in its home market of Panama, which is fully and legally dollarized, as well as in its other main markets, most of which are either fully or highly dollarized.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails. CR Assessments are distinct from debt and deposit ratings in that they (1) consider only the risk of default, rather than both the likelihood of default and the expected financial loss; and (2) apply to counterparty obligations and contractual commitments, rather than debt or deposit instruments. The CR Assessment is an opinion of 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.

BAC's CR Assessment is positioned at Baa3(cr)/Prime-3(cr)

BAC's CR Assessment, before government support, is positioned one notch above the bank's Adjusted BCA of ba1 and, therefore, above the deposit ratings. This reflects our view that the probability of default is lower than that of deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved to limit contagion, minimize losses and avoid disruption of critical functions.

We do not assign any uplift from government support for the CR Assessment, in line with the deposit ratings.

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 for 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.

BAC's CRRs are positioned at Baa3/Prime-3

BAC's CRRs, before government support, are positioned one notch above the Adjusted BCA of ba1 and, therefore, above deposit ratings. This reflects our view that BAC's CRR liabilities have a lower probability of default than the bank's deposits as they will more likely be preserved to minimize banking system contagion and losses, and avoid disruption of critical functions.

The CRRs do not incorporate government support, in line with our support assumptions on deposits.

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

BAC International Bank, Inc

Macro Factors		
Weighted Macro Profile	**Weak +**	**100%**

Factor	**Historic Ratio**	**Initial Score**	**Expected Trend**	**Assigned Score**	**Key driver #1**	**Key driver #2**
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.3%	baa3	↔	ba1	Expected trend	
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel III - transitional phase-in)	15.1%	baa3	↔	ba2	Expected trend	
Profitability						
Net Income / Tangible Assets	1.5%	ba2	↔	ba1	Expected trend	
Combined Solvency Score		baa3		ba1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	12.3%	ba2	↔	ba1	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	26.5%	ba2	↔	ba2		
Combined Liquidity Score		ba2		ba1		
Financial Profile				ba1		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Baa1		
BCA Scorecard-indicated Outcome - Range				baa3 - ba2		
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	0		Baa3
Counterparty Risk Assessment	1	0	baa3 (cr)	0	Baa3(cr)	
Deposits	0	0	ba1	0	Ba1	Ba1

[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
BAC INTERNATIONAL BANK, INC	
Outlook	Stable
Counterparty Risk Rating	Baa3/P-3
Bank Deposits	Ba1/NP
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa3(cr)/P-3(cr)
PARENT: BANCO DE BOGOTA S.A.	
Outlook	Negative
Counterparty Risk Rating	Baa2/P-2
Bank Deposits	Baa2/P-2
Baseline Credit Assessment	ba1
Adjusted Baseline Credit Assessment	ba1
Counterparty Risk Assessment	Baa2(cr)/P-2(cr)
Senior Unsecured	Baa2
Subordinate	Ba2
ULT PARENT: GRUPO AVAL ACCIONES Y VALORES S.A.	
Outlook	Negative
Issuer Rating	Ba2
ST Issuer Rating	NP

Source: Moody's Investors Service

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