

CREDIT OPINION

23 May 2016

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RATINGS

Banco de Desarrollo de El Salvador

Domicile	El Salvador
Long Term Rating	Ba3
Type	LT Issuer Rating - Fgn Curr
Outlook	Negative

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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Banco de Desarrollo de El Salvador

Updates to Credit Strengths & Challenges

Summary Rating Rationale

Moody's assigns a Ba3 foreign currency issuer rating, with a negative outlook, to Banco de Desarrollo de El Salvador (BANDESAL), the country's development bank. BANDESAL is 100%-owned by the Salvadoran State (Ba3, negative) via the central Bank, Banco Central de Reserva de El Salvador (BCRES).

The bank's credit assessment is intrinsically intertwined with that of the sovereign given the close financial and managerial linkages between both, coupled with its relevant mission to promote economic development. Further, it benefits from a preferential creditor status, which enables it to directly access the reserve accounts of regulated financial institutions at the BCRES in the case of non-payment of loans. This facility covers around three-quarters of the loan portfolio.

BANDESAL's issuer rating derives from Moody's rating methodology for government-related issuers (GRIs) and incorporates the BCA of ba3 as well as the assessment of a high probability of support from the Salvadoran government. As the country's financial system is legally dollarized, Moody's does not assign BANDESAL local currency ratings.

As its main activity, the bank lends chiefly to Salvadoran financial institutions, which in turn on-lend the funds to customers engaged in pre-approved private-sector development projects. BANDESAL's activities were expanded in 2012 to include direct lending operations to small- and medium-sized companies, as well as fostering job generation. The bank was originally established as Banco Multisectorial de Inversiones (BMI) by special legislative act in 1994 and was spun off from the central bank under the aegis of the Inter-American Development Bank (IDB).

Credit Strengths

- » Preferred creditor status, enabling BANDESAL to directly access the reserve accounts of regulated financial institutions at the central bank
- » Robust core capitalization

Credit Challenges

- » Modest profitability due to low margins and weak efficiency
- » Reliance on wholesale market funding

Rating Outlook

The rating outlook is negative.

Factors that Could Lead to an Upgrade

Should El Salvador's government bond rating be downgraded, BANDESAL's Ba3 foreign currency issuer rating would be downgraded as well, while the ba3 BCA would be lowered.

Factors that Could Lead to a Downgrade

Upward pressures on BANDESAL's issuer rating are limited given the negative outlook on the sovereign.

Key Indicators

Exhibit 1

Banco de Desarrollo de El Salvador (Consolidated Financials) [1]

	3-16 ²	12-15 ²	12-14 ²	12-13 ²	12-12 ²	Avg.
Total Assets (USD million)	560.7	560.6	521.8	540.6	514.5	2.2 ³
Tangible Common Equity (USD million)	223.4	223.2	218.9	214.9	202.8	2.5 ³
Tangible Common Equity / Risk Weighted Assets (%)	40.8	40.7	41.8	34.4	32.7	38.1 ⁴
Net Interest Margin (%)	2.1	2.2	2.5	2.3	1.6	2.1 ⁵
PPI / Average RWA (%)	1.0	1.2	1.6	1.2	0.8	1.2 ⁴
Net Income / Tangible Assets (%)	0.6	0.9	0.9	0.9	0.9	0.8 ⁵
Cost / Income Ratio (%)	53.0	46.8	39.1	41.1	54.1	46.8 ⁵
Market Funds / Tangible Banking Assets (%)	59.5	59.7	57.5	59.3	58.6	58.9 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	28.3	28.8	28.4	35.2	39.9	32.1 ⁵

[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] Basel I & LOCAL GAAP reporting periods have been used for average calculation [5] LOCAL GAAP reporting periods have been used for average calculation

Source: Moody's Financial Metrics

Detailed Rating Considerations

PREFERRED CREDITOR STATUS, ENABLING BANDESAL TO DIRECTLY ACCESS THE RESERVE ACCOUNTS OF REGULATED FINANCIAL INSTITUTIONS AT THE CENTRAL BANK

Asset quality remains a strength for BANDESAL given its preferred creditor status in El Salvador, coupled with prudent risk-management and reserving practices. Per article 6 of the Development Bank Law (Ley del Sistema Financiero para el Fomento del Desarrollo), BANDESAL can get access to the reserve accounts of regulated banks and some non-banks at Central Bank, to ensure proper and timely payment of a given loan. The portfolio of loans to unregulated saving banks ("cajas"), cooperatives and direct lending is not covered by this mechanism. As of March 2016, BANDESAL had a preferential creditor status on about 90% of its total portfolio, similar to the figures posted by the same date last year.

Nonperforming loans have been posted at zero since 2006. As of March 2016, some 40% of total loans were to regulated commercial banks, 28% to State owned banks, 19% to cooperative banks and 10% to non regulated "cajas" and 4% to government-sponsored funds. Regarding the final destination of loans, about 45% of lending was eventually granted to SMEs, followed by self-employed individuals (30%). Loans to medium and large companies were a more moderate 16% and 9% of total on-lending.

BANDESAL constitutes provisions for possible loan and investment losses. The loan-loss reserve policy includes a 1% voluntary reserve in addition to specific reserves, a policy based on forward-looking risk profiles. As of March 2016, the fifth and tenth largest borrowers comprised 65% and 87% of total loans. Largest exposures are largely devoted to government-owned banks and large domestic private commercial banks. Particularly, BANDESAL largest loan comprises 19% of total loans. In spite of about half of the portfolio being devoted to broad segments of the economy such as commerce (25% of loans) and services (18%), we note significant concentrations in riskier sectors such as agribusiness and housing (17% each).

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MODEST PROFITABILITY DUE TO LOW MARGINS AND WEAK EFFICIENCY

BANDESAL's earnings stream has been intrinsically modest, as evidenced by return on assets consistently below 1%. This derives from a thin net interest margins (NIM), which averaged a modest 2% since 2010, a byproduct of the bank's development role and a loan book largely devoted to financial institutions. Moreover, we note the high levels of operating expenses vis-à-vis operating income despite not having a branch network, as evidenced by an average cost-income ratio of around 50% as of

2016.

RELIANCE ON WHOLESALE MARKET FUNDING

BANDESAL depends entirely on wholesale funding, as it cannot take deposits from the public per the Development Bank Law. As of March 2016, lines from commercial banks comprised 38% of total funding, while issued debt represented 5%. The remaining of the funding is composed by lines from the Central Bank (14% of assets) and capital (40%).

Funding is medium term in nature, with 76% of it (including capital), being due in more than one year as of March 2016. This allows an adequate match with the longer loan portfolio, 75% of which matures in more than a year. As a result, BANDESAL shows positive cumulative tenor matches over the short term.

Liquidity has remained robust. Liquid assets comprised around 30% of total assets as of 2016, down from 35% and 40% in 2013 and 2012 as the bank used it to fund growth. Liquidity is largely invested in Salvadoran government securities (75% of liquid assets) as well as bank deposits and cash (25%).

ROBUST CORE CAPITALIZATION

BANDESAL has maintained strong risk-weighted capitalization that allows for a substantial cushion to absorb losses. As of March 2016, Tangible Common Equity represented about 40% of adjusted risk-weighted assets.

Foreign Currency Issuer Rating

Moody's assigns a Ba3 foreign currency issuer rating, with a negative outlook, to BANDESAL. The rating is in line with the Ba3 rating, with a negative outlook, of its ultimate shareholder, the Republic of El Salvador, as well as reflecting our assessment of high dependence and high support from the latter.

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Ratings

Exhibit 2

Category	Moody's Rating
BANCO DE DESARROLLO DE EL SALVADOR	
Outlook	Negative
Baseline Credit Assessment	ba3
Adjusted Baseline Credit Assessment	ba3
Issuer Rating	Ba3

Source: Moody's Investors Service

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