

CREDIT OPINION

14 November 2016

Update

Rate this Research >>

Contacts

Georges Hatcherian 52-55-1555-5301
 Analyst
 georges.hatcherian@moodys.com

Vicente Gomez 52-55-1555-5304
 Associate Analyst
 vicente.gomez@moodys.com

Felipe Carvallo 52-55-1253-5738
 VP-Senior Analyst
 felipe.carvallo@moodys.com

Banco de Desarrollo de El Salvador

Update Following the Recent Downgrade to B3 Negative

Summary Rating Rationale

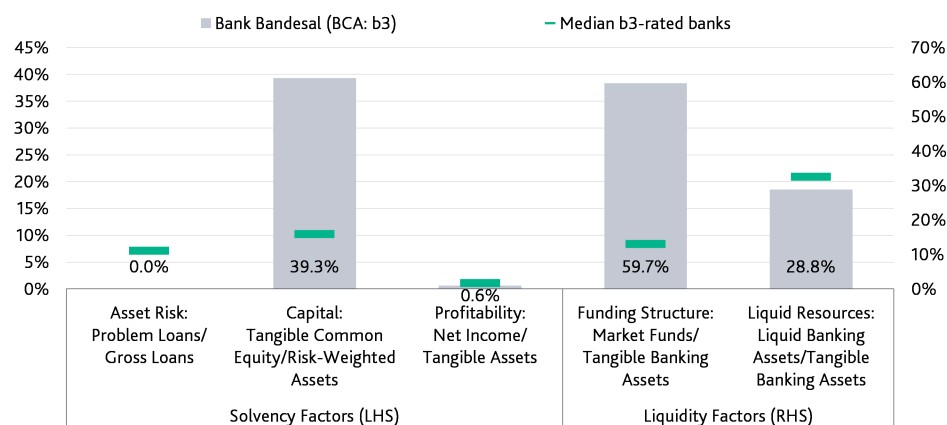
On 9 November, Moody's downgraded to B3, from B1, the long-term foreign currency issuer rating of Banco de Desarrollo de El Salvador (Bandesal), the country's development bank. The bank's standalone baseline credit assessment (BCA) was also downgraded to b3, from b1.

These rating actions follow Moody's downgrade of El Salvador's government bond rating to B3, from B1, with a negative outlook. For details on the rating action on El Salvador please refer to Moody's press release "[Moody's downgrades El Salvador's government bond ratings to B3 negative, concluding review for downgrade](#)," published on 7 November 2016.

The lower BCA reflects our view that the creditworthiness of the bank is intrinsically interlinked with that of the Salvadoran government, as its funding, liquidity position and market access are closely tied to El Salvador's own liquidity pressures.

Exhibit 1

Rating Scorecard - Key Financial Ratios



Source: Moody's Financial Metrics

Credit Strengths

- » Strong asset quality supported by Badesal's preferred creditor status
- » Robust core capitalization

Credit Challenges

- » Reliance on wholesale market funds adds to refinancing risks
- » Weakening profitability due to rising funding costs
- » Badesal's BCA is constrained by El Salvador's "Very Weak +" Macro Profile

Rating Outlook

The outlook on Badesal's long-term foreign currency issuer rating is negative in line with the negative outlook on El Salvador's government bond rating

Factors that Could Lead to an Upgrade

Because Badesal's financial strength is limited by the creditworthiness of the Salvadoran government, there is no upward pressure at this juncture. However, the outlook is likely to be stabilized if and when the outlook on the government bond rating returns to stable.

Factors that Could Lead to a Downgrade

If El Salvador's government bond rating is downgraded further, Badesal's ratings and assessments are likely to be downgraded again as well.

Key Indicators

Exhibit 2

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

	6-16 ²	12-15 ²	12-14 ²	12-13 ²	12-12 ²	Avg. ³
Total Assets (USD million)	588.1	560.6	521.8	540.6	514.5	3.4 ³
Tangible Common Equity (USD million)	224.2	223.2	218.9	214.9	202.8	2.5 ³
Tangible Common Equity / Risk Weighted Assets (%)	39.2	40.7	41.8	34.4	32.7	37.8 ⁴
Net Interest Margin (%)	2.0	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 (%)	53.6	46.8	39.1	41.1	54.1	46.9 ⁵
Market Funds / Tangible Banking Assets (%)	61.6	59.7	57.5	59.3	58.6	59.3 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	29.1	28.8	28.4	35.2	39.9	32.3 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

RELIANCE ON WHOLESALE MARKET FUNDS ADDS TO REFINANCING RISKS

Badesal depends entirely on wholesale funding as it cannot take deposits from the public as per the Development Bank Law. As of June 2016, lines from commercial banks comprised 44% of its total assets, while issued debt represented 2.5%. The remainder of the funding is composed by lines from the Central Reserve Bank of El Salvador (13% of assets) and shareholders' equity (38%).

Funding is medium-term in nature, with the majority of it being due in more than one year as of June 2016. This allows an adequate match with the longer loan portfolio, as 77% of it matures in more than a year. As a result, Badesal shows positive cumulative tenor matches over the short term.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

Liquid assets comprised around 29% 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 (70% of liquid assets) as well as bank deposits and cash (30%).

However, if the Salvadoran government continues to rely on short-term debt financing due to its inability to recur to long-term indebtedness, Bandedal's funding and liquidity profile could deteriorate as the bank's liquidity position and market access are closely tied to the government's own funding and liquidity profile.

WEAKENING PROFITABILITY DUE TO RISING FUNDING COSTS

Bandedal's profitability has historically been modest, with return on assets consistently below 1%. This derives from thin net interest margins, which averaged a modest 2% since 2010, a by-product of the bank's developmental role and a loan book largely devoted to financial institutions.

As of June 2016, the net income to tangible assets hit a historic low at 0.6% reflecting the increase in funding costs given higher international dollar rates amid a deteriorating sovereign creditworthiness. The consequential increases of the bank's funding costs have not been transferred to its loan book, given its public policy mandate. At the same time, high operating costs continued to erode returns. As of June 2016, Bandedal, despite not having a branch network, had a cost-income ratio of a high 55%. We also note that Bandedal had to pay a new special tax to fund public safety.

STRONG ASSET QUALITY SUPPORTED BY BANDESAL'S PREFERRED CREDITOR STATUS

Asset quality remains a strength for Bandedal 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),

Bandedal can have access to the reserve accounts of regulated banks and some non-banks at the 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 June 2016, Bandedal had a preferential creditor status on about 85% of its total portfolio, similar to the figures posted by the same date last year. Nonperforming loans have been posted at zero since 2006.

Bandedal 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 June 2016, the fifth and tenth largest borrowers comprised 53% and 76% of total gross loans. Largest exposures are largely devoted to government-owned banks and large domestic private commercial banks. Bandedal direct lending encompasses only 6% of its total gross loans.

ROBUST CORE CAPITALIZATION

Bandedal has maintained strong risk-weighted capitalization that allows for a substantial cushion to absorb losses. As of June 2016, Tangible Common Equity represented about 39.3% of adjusted risk-weighted assets.

BANDESAL'S BCA IS CONSTRAINED BY EL SALVADOR'S "VERY WEAK +" MACRO PROFILE

El Salvador has a small economy with weak growth prospects, weighed down by low investment and limited improvements in productivity. Although dollarization has helped keep inflation low, it has also limited the economic policy tools available to local authorities to spur greater economic growth. In addition, the country has a fragile rule of law and suffers from widespread security problems. Credit penetration is in line with the average across Latin America, although loan growth has lagged other regional peers as a result of the country's lackluster economic expansion. Asset risks related to exposures to short-term government securities (LETES) have risen this year as a result of the government's liquidity strains. Further, consumer lending growth has accelerated in recent years, leaving banks more susceptible to asset quality problems in the event of a more pronounced downturn in the economy, or a decline in remittances. The Salvadoran banking system is largely foreign owned and moderately concentrated.

Rating Methodology and Scorecard Factors

Exhibit 3

Banco de Desarrollo de El Salvador

Macro Factors

Weighted Macro Profile	Very Weak +	100%
-------------------------------	--------------------	-------------

Financial Profile

Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans		ba1	← →	b1		
Capital						
TCE / RWA	39.2%	ba1	← →	ba1		
Profitability						
Net Income / Tangible Assets	0.6%	caa1	← →	caa1		
Combined Solvency Score		ba2		b1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	59.7%	caa2	← →	caa3		
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	28.8%	b3	← →	b3		
Combined Liquidity Score		caa1		caa2		
Financial Profile				b2		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint:				WR		
Scorecard Calculated BCA range				b2-cao1		
Assigned BCA				b3		
Affiliate Support notching				0		
Adjusted BCA				b3		
Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency rating	Foreign Currency rating

Source: Moody's Financial Metrics

Notching Considerations

Foreign Currency Issuer Rating

Bandesal's B3 foreign currency issuer rating, with a negative outlook, is in line with El Salvador's B3 government bond rating, also with a negative outlook. It also reflects our assessment of a high probability of extraordinary public support to the bank in the case of need, though this assessment does not yield in a rating uplift at this time.

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.

Ratings

Exhibit 4

Category	Moody's Rating
BANCO DE DESARROLLO DE EL SALVADOR	
Outlook	Negative
Baseline Credit Assessment	b3
Adjusted Baseline Credit Assessment	b3
Issuer Rating	B3

Source: Moody's Investors Service

© 2016 Moody's Corporation, Moody's Investors Service, Inc., Moody's Analytics, Inc. and/or their licensors and affiliates (collectively, "MOODY'S"). All rights reserved.

CREDIT RATINGS ISSUED BY MOODY'S INVESTORS SERVICE, INC. AND ITS RATINGS AFFILIATES ("MIS") ARE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES, AND CREDIT RATINGS AND RESEARCH PUBLICATIONS PUBLISHED BY MOODY'S ("MOODY'S PUBLICATIONS") MAY INCLUDE MOODY'S CURRENT OPINIONS OF THE RELATIVE FUTURE CREDIT RISK OF ENTITIES, CREDIT COMMITMENTS, OR DEBT OR DEBT-LIKE SECURITIES. MOODY'S DEFINES CREDIT RISK AS THE RISK THAT AN ENTITY MAY NOT MEET ITS CONTRACTUAL, FINANCIAL OBLIGATIONS AS THEY COME DUE AND ANY ESTIMATED FINANCIAL LOSS IN THE EVENT OF DEFAULT. CREDIT RATINGS DO NOT ADDRESS ANY OTHER RISK, INCLUDING BUT NOT LIMITED TO: LIQUIDITY RISK, MARKET VALUE RISK, OR PRICE VOLATILITY. CREDIT RATINGS AND MOODY'S OPINIONS INCLUDED IN MOODY'S PUBLICATIONS ARE NOT STATEMENTS OF CURRENT OR HISTORICAL FACT. MOODY'S PUBLICATIONS MAY ALSO INCLUDE QUANTITATIVE MODEL-BASED ESTIMATES OF CREDIT RISK AND RELATED OPINIONS OR COMMENTARY PUBLISHED BY MOODY'S ANALYTICS, INC. CREDIT RATINGS AND MOODY'S PUBLICATIONS DO NOT CONSTITUTE OR PROVIDE INVESTMENT OR FINANCIAL ADVICE, AND CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT AND DO NOT PROVIDE RECOMMENDATIONS TO PURCHASE, SELL, OR HOLD PARTICULAR SECURITIES. NEITHER CREDIT RATINGS NOR MOODY'S PUBLICATIONS COMMENT ON THE SUITABILITY OF AN INVESTMENT FOR ANY PARTICULAR INVESTOR. MOODY'S ISSUES ITS CREDIT RATINGS AND PUBLISHES MOODY'S PUBLICATIONS WITH THE EXPECTATION AND UNDERSTANDING THAT EACH INVESTOR WILL, WITH DUE CARE, MAKE ITS OWN STUDY AND EVALUATION OF EACH SECURITY THAT IS UNDER CONSIDERATION FOR PURCHASE, HOLDING, OR SALE.

MOODY'S CREDIT RATINGS AND MOODY'S PUBLICATIONS ARE NOT INTENDED FOR USE BY RETAIL INVESTORS AND IT WOULD BE RECKLESS AND INAPPROPRIATE FOR RETAIL INVESTORS TO USE MOODY'S CREDIT RATINGS OR MOODY'S PUBLICATIONS WHEN MAKING AN INVESTMENT DECISION. IF IN DOUBT YOU SHOULD CONTACT YOUR FINANCIAL OR OTHER PROFESSIONAL ADVISER. ALL INFORMATION CONTAINED HEREIN IS PROTECTED BY LAW, INCLUDING BUT NOT LIMITED TO, COPYRIGHT LAW, AND NONE OF SUCH INFORMATION MAY BE COPIED OR OTHERWISE REPRODUCED, REPACKAGED, FURTHER TRANSMITTED, TRANSFERRED, DISSEMINATED, REDISTRIBUTED OR RESOLD, OR STORED FOR SUBSEQUENT USE FOR ANY SUCH PURPOSE, IN WHOLE OR IN PART, IN ANY FORM OR MANNER OR BY ANY MEANS WHATSOEVER, BY ANY PERSON WITHOUT MOODY'S PRIOR WRITTEN CONSENT.

All information contained herein is obtained by MOODY'S from sources believed by it to be accurate and reliable. Because of the possibility of human or mechanical error as well as other factors, however, all information contained herein is provided "AS IS" without warranty of any kind. MOODY'S adopts all necessary measures so that the information it uses in assigning a credit rating is of sufficient quality and from sources MOODY'S considers to be reliable including, when appropriate, independent third-party sources. However, MOODY'S is not an auditor and cannot in every instance independently verify or validate information received in the rating process or in preparing the Moody's Publications.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability to any person or entity for any indirect, special, consequential, or incidental losses or damages whatsoever arising from or in connection with the information contained herein or the use of or inability to use any such information, even if MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers is advised in advance of the possibility of such losses or damages, including but not limited to: (a) any loss of present or prospective profits or (b) any loss or damage arising where the relevant financial instrument is not the subject of a particular credit rating assigned by MOODY'S.

To the extent permitted by law, MOODY'S and its directors, officers, employees, agents, representatives, licensors and suppliers disclaim liability for any direct or compensatory losses or damages caused to any person or entity, including but not limited to by any negligence (but excluding fraud, willful misconduct or any other type of liability that, for the avoidance of doubt, by law cannot be excluded) on the part of, or any contingency within or beyond the control of, MOODY'S or any of its directors, officers, employees, agents, representatives, licensors or suppliers, arising from or in connection with the information contained herein or the use of or inability to use any such information.

NO WARRANTY, EXPRESS OR IMPLIED, AS TO THE ACCURACY, TIMELINESS, COMPLETENESS, MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY SUCH RATING OR OTHER OPINION OR INFORMATION IS GIVEN OR MADE BY MOODY'S IN ANY FORM OR MANNER WHATSOEVER.

Moody's Investors Service, Inc., a wholly-owned credit rating agency subsidiary of Moody's Corporation ("MCO"), hereby discloses that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by Moody's Investors Service, Inc. have, prior to assignment of any rating, agreed to pay to Moody's Investors Service, Inc. for appraisal and rating services rendered by it fees ranging from \$1,500 to approximately \$2,500,000. MCO and MIS also maintain policies and procedures to address the independence of MIS's ratings and rating processes. Information regarding certain affiliations that may exist between directors of MCO and rated entities, and between entities who hold ratings from MIS and have also publicly reported to the SEC an ownership interest in MCO of more than 5%, is posted annually at www.moody's.com under the heading "Investor Relations — Corporate Governance — Director and Shareholder Affiliation Policy."

Additional terms for Australia only: Any publication into Australia of this document is pursuant to the Australian Financial Services License of MOODY'S affiliate, Moody's Investors Service Pty Limited ABN 61 003 399 657 AFSL 336969 and/or Moody's Analytics Australia Pty Ltd ABN 94 105 136 972 AFSL 383569 (as applicable). This document is intended to be provided only to "wholesale clients" within the meaning of section 761G of the Corporations Act 2001. By continuing to access this document from within Australia, you represent to MOODY'S that you are, or are accessing the document as a representative of, a "wholesale client" and that neither you nor the entity you represent will directly or indirectly disseminate this document or its contents to "retail clients" within the meaning of section 761G of the Corporations Act 2001. MOODY'S credit rating is an opinion as to the creditworthiness of a debt obligation of the issuer, not on the equity securities of the issuer or any form of security that is available to retail investors. It would be reckless and inappropriate for retail investors to use MOODY'S credit ratings or publications when making an investment decision. If in doubt you should contact your financial or other professional adviser.

Additional terms for Japan only: Moody's Japan K.K. ("MJKK") is a wholly-owned credit rating agency subsidiary of Moody's Group Japan G.K., which is wholly-owned by Moody's Overseas Holdings Inc., a wholly-owned subsidiary of MCO. Moody's SF Japan K.K. ("MSFJ") is a wholly-owned credit rating agency subsidiary of MJKK. MSFJ is not a Nationally Recognized Statistical Rating Organization ("NRSRO"). Therefore, credit ratings assigned by MSFJ are Non-NRSRO Credit Ratings. Non-NRSRO Credit Ratings are assigned by an entity that is not a NRSRO and, consequently, the rated obligation will not qualify for certain types of treatment under U.S. laws. MJKK and MSFJ are credit rating agencies registered with the Japan Financial Services Agency and their registration numbers are FSA Commissioner (Ratings) No. 2 and 3 respectively.

MJKK or MSFJ (as applicable) hereby disclose that most issuers of debt securities (including corporate and municipal bonds, debentures, notes and commercial paper) and preferred stock rated by MJKK or MSFJ (as applicable) have, prior to assignment of any rating, agreed to pay to MJKK or MSFJ (as applicable) for appraisal and rating services rendered by it fees ranging from JPY200,000 to approximately JPY350,000,000.

MJKK and MSFJ also maintain policies and procedures to address Japanese regulatory requirements.

REPORT NUMBER 1049841

Contacts

Georges Hatcherian
Analyst
georges.hatcherian@moodys.com

52-55-1555-5301

Vicente Gomez
Associate Analyst
vicente.gomez@moodys.com

52-55-1555-5304

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454