

Banco Davivienda S.A.

Primary Credit Analyst:

Alfredo Enrique Calvo, Mexico City (52) 55-5081-4436; alfredo_calvo@standardandpoors.com

Secondary Credit Analyst:

Martin Samper, Mexico City (52) 55-5081-4474; martin_samper@standardandpoors.com

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Major Rating Factors

Strengths

- Strong market position in the Colombian banking system;
- Good profitability levels;
- Adequate asset quality metrics; and
- Good financial flexibility.

Weaknesses

- Moderate capitalization levels;
- Limited geographic diversification compared with its peers; and
- Strong competition in the Colombian banking industry.

Counterparty Credit Rating

BBB-/Watch Neg/A-3

Rationale

Standard & Poor's Ratings Services' ratings on Banco Davivienda S.A. reflect its "strong" business stability (as our criteria defines it) and the adequate diversification of its business activities. The ratings also reflect the bank's "above average" funding profile and "adequate" liquidity. Counterbalancing the positive factors are Davivienda's moderate risk-adjusted capital (RAC) ratio and its aggressive growth strategy, which could pressure its "adequate" risk position. The ICR on Davivienda incorporates one notch of support, reflecting a moderately high likelihood of extraordinary government support in the future.

On Jan. 24, 2012 Davivienda announced its agreement with HSBC Holdings PLC (A+/Stable/A-1) to acquire its subsidiaries--banks, insurance companies, and other finance companies-- in El Salvador, Costa Rica, and Honduras. We expect this transaction to be closed by the fourth quarter of 2012, subject to the respective countries' regulatory approval.

Prior to the announced acquisition, our assessment of its "moderate" capital was the bank's main weakness. Our forecasted risk-adjusted capital (RAC), before the acquisition announcement, was between 5.5% and 6.5%. However, we consider that a higher-than-expected loan growth for 2012, as a result of the internal and acquisition-led expansion, would pressure the bank's capitalization. In addition, the goodwill that this transaction would bring to Davivienda's balance sheet would also affect capital. Even though the bank's capital strengthened during the last quarter of 2011, mainly through the issuance of preferred shares, the total amount of these instruments is not accounted for in our total adjusted capital. Per our criteria, these preferred shares have intermediate equity content. Currently, we are evaluating if the acquisition and the organic growth projected for 2012 would lead us to change our assessment of its capital to "weak" from "moderate".

The 'bbb-' anchor draws on our Banking Industry Country Risk Assessment (BICRA) methodology and our view of the economic and industry risk in Colombia where Davivienda predominantly operates. Our bank criteria use the BICRA economic and industry risk scores to determine a bank's anchor, the starting point in assigning an ICR. Our economic risk score of '6' on Colombia reflects its economic concentration to cyclical sectors (commodities), limited fiscal flexibility based on the population's low income levels (from a global perspective), high unemployment rate,

and an inefficient rule of law that hinders claims process over loan collaterals. On the positive side we do not see any asset bubbles in the Colombian economy at this stage. Our industry risk score of '5' is based on Colombia's improvements regarding underwriting standards, transparency, and good disclosure of accounts and ownership of banks, which have created favorable conditions and strengthened supervision and coverage. The central bank's lending facilities and policies are adequate in terms of its capacity and good track record of providing guarantees, transparency, and liquidity. In addition, banks in Colombia enjoy a stable and expanding core customer deposit base. However, in our opinion, the country's still-shallow capital markets, lack of long-term funding alternatives (which harms asset-liability management), and moderate use of securitization continue to constrain the industry.

We derive our assessment of Davivienda's "adequate" business position from its strong presence in the Colombian banking sector and its leadership in the consumer segment. Davivienda is the third-largest bank in Colombia with a market share of loans and deposits of 13% and 12%, respectively (as of September 2011), reflecting the strength of its business stability. The bank's "adequate" diversification of business activities also supports its business position. Davivienda was established as a savings and mortgage corporation, but has diversified its business through acquisitions and organic growth. Currently, Davivienda's business portfolio consists of corporate and commercial loans (51%), retail loans (33%), and mortgages (16%). We expect that Davivienda will maintain its strong position in the Colombian banking system, based on what we consider aggressive loan-growth rates. In the near term, we believe that its business position will benefit from its already agreed upon acquisitions in Central America, which would complement its geographic diversification strategy.

In our opinion, Davivienda has "above-average" funding and "adequate" liquidity. Even though the bank's loans-to-deposits ratio has been more than 100%, Davivienda's well-diversified funding structure mitigates this situation--a characteristic typical of the Colombian banking industry. The bank's funding structure is mainly composed of deposits that represented 75% of its funding sources as of September 2011. Interbank facilities and senior unsecured notes represent 13% and 9% of its funding sources, respectively. Subordinated debt constitutes 3% of funding. In our opinion, Davivienda's liquidity is "adequate," considering that its nondeposit funding sources are fully covered by cash and securities for trading available for sale. In addition, these liquid assets represented about 30% of its deposits as of September 2011.

We assess Davivienda's risk position as "adequate," mainly reflecting the bank's adequate risk diversification and limited credit losses; the bank's good recovery process has supported its ability to mitigate the pressure of the losses. Although Davivienda's conservative underwriting practices and long track record in the retail and mortgage segments somewhat mitigate its aggressive growth strategy, we consider its growth strategy a potential constraint on the ratings. The resulting loan growth would pressure its already moderate capital, and could result in changes in loan composition and exposure to countries with higher BICRA scores. These would be risks not covered by our RAC framework that could result in higher charges in capitalization.

Before the acquisition announcement, we viewed Davivienda's capital and earnings as "moderate." Davivienda's adequate earnings quality and earnings capacity would support its capital base. We were expecting core earnings on average adjusted assets to be about 1.5% during the following 12-18 months, considering the good prospects for the Colombian economy and our loan-growth estimates. The issuance of additional preferred shares during the last quarter of 2011 are supportive of Davivienda's capital. However, based on the bank's aggressive growth strategy for 2012, we believe capitalization will be under pressure.

We assess the Colombian government as "supportive" of Colombian banks, and we believe that Davivienda has a

high systemic importance for the Colombian financial system. Thus, we believe that Davivienda has a moderately high likelihood of receiving extraordinary government support.

CreditWatch

We will resolve the CreditWatch listing once pro forma financials are available and we get more information about the bank's business plan, particularly with regard to this acquisition. This would allow us to assess Davivienda's future capital and earnings levels under our criteria. The approval from the respective regulators (expected by fourth quarter 2012) is also a fundamental factor for resolving the CreditWatch.

Related Criteria And Research

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- BICRA On Colombia Revised To Group '5' From Group '6', Nov. 9, 2011
- Bank Hybrid Capital Methodology And Assumptions, Oct. 24, 2011

Table 1

| Banco Davivienda S.A. Key Figures | | | | | |
|--|-------------------------------|--------------|--------------|--------------|--------------|
| | --Year-ended Dec. 31-- | | | | |
| (Mil. COP) | 2011* | 2010 | 2009 | 2008 | 2007 |
| Adjusted assets | 33,862,826.0 | 28,352,441.6 | 24,805,645.4 | 21,387,228.1 | 18,781,156.5 |
| Customer loans (gross) | 25,739,234.0 | 21,935,171.1 | 18,195,098.8 | 16,199,208.1 | 13,917,743.7 |
| Adjusted common equity | 2,286,401.0 | 1,875,137.6 | 1,329,860.4 | 819,040.5 | 292,096.9 |
| Operating revenues | 3,011,353.0 | 3,623,899.3 | 3,368,621.6 | 3,989,584.9 | 2,455,231.9 |
| Noninterest expenses | 1,199,117.0 | 1,510,537.3 | 1,240,072.1 | 2,107,156.4 | 1,026,464.0 |
| Core earnings | 387,298.7 | 442,998.8 | 350,112.2 | 326,453.8 | 357,753.2 |

*Data as of Sept. 30.

COP--COP-Colombian peso. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 2

| Banco Davivienda S.A. Capital And Earnings | | | | | |
|---|-------------------------------|-------------|-------------|-------------|-------------|
| | --Year-ended Dec. 31-- | | | | |
| (Mil. COP) | 2011* | 2010 | 2009 | 2008 | 2007 |
| Tier 1 capital ratio | 9.5 | 9.6 | 8.4 | 8.3 | 9.0 |
| S&P RAC ratio before diversification | N.M. | N.M. | N.M. | N.M. | N.M. |
| S&P RAC ratio after diversification | N.M. | N.M. | N.M. | N.M. | N.M. |
| Adjusted common equity/total adjusted capital | 84.6 | 81.8 | 100.0 | 100.0 | 100.0 |
| Double leverage | N.M. | N.M. | N.M. | N.M. | N.M. |
| Net interest income/operating revenues | 55.6 | 47.2 | 41.9 | 34.6 | 42.0 |
| Fee income/operating revenues | 16.9 | 12.2 | 11.1 | 5.0 | 4.4 |
| Market-sensitive income/operating revenues | N/A | 6.5 | 9.0 | 8.9 | 12.2 |
| Noninterest expenses/operating revenues | 39.8 | 41.7 | 36.8 | 52.8 | 41.8 |
| Provision operating income/average assets | 7.5 | 7.6 | 8.7 | 8.7 | 9.3 |

Table 2

| Banco Davivienda S.A. Capital And Earnings (cont.) | | | | | |
|--|-----|-----|-----|-----|-----|
| Core earnings/average managed assets | 1.6 | 1.6 | 1.4 | 1.5 | 2.3 |

*Data as of Sept. 30.

COP--COP-Colombian peso. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 3

| Banco Davivienda S.A. Risk Position | | | | | |
|---|-------|------------------------|-------|-------|-------|
| (Mil. COP) | 2011* | --Year-ended Dec. 31-- | | | |
| | | 2010 | 2009 | 2008 | 2007 |
| Growth in customer loans | 23.1 | 20.6 | 12.3 | 16.4 | 96.6 |
| Total diversification adjustment / S&P RWA before diversification | N.M. | N.M. | N.M. | N.M. | N.M. |
| Total managed assets/adjusted common equity (x) | 15.3 | 15.8 | 19.7 | 27.9 | 69.7 |
| New loan loss provisions/average customer loans | 7.3 | 7.7 | 9.9 | 9.9 | 9.4 |
| Net charge-offs/average customer loans | (1.6) | (2.4) | (1.3) | (1.1) | (2.4) |
| Gross nonperforming assets/customer loans + other real estate owned | 2.1 | 2.0 | 2.5 | 2.5 | 2.6 |
| Loan loss reserves/gross nonperforming assets | 249.3 | 260.7 | 244.1 | 236.6 | 217.3 |

*Data as of Sept. 30.

COP--COP-Colombian peso. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Table 4

| Banco Davivienda S.A. Funding And Liquidity | | | | | |
|--|--------|------------------------|-------|-------|-------|
| (Mil. COP) | 2011* | --Year-ended Dec. 31-- | | | |
| | | 2010 | 2009 | 2008 | 2007 |
| Core deposits/funding base | 74.5 | 77.7 | 81.7 | 85.1 | 85.0 |
| Customer loans (net)/customer deposits | 110.9 | 107.3 | 93.1 | 91.1 | 87.4 |
| Long term funding ratio | 87.9 | 90.6 | 90.2 | 90.1 | 88.6 |
| Broad liquid assets/short-term wholesale funding (x) | 0.5 | 0.5 | 0.5 | 0.7 | 0.6 |
| Net broad liquid assets/short-term customer deposits | (14.7) | (11.3) | (8.4) | (5.1) | (8.1) |
| Narrow liquid assets/3-month wholesale funding (x) | N/A | N/A | N/A | N/A | N/A |
| Net short-term interbank funding/total wholesale funding | 45.7 | 37.7 | 39.2 | 32.6 | 61.7 |
| Short-term wholesale funding/total wholesale funding | 60.9 | 55.1 | 65.3 | 79.4 | 85.1 |

*Data as of Sept. 30.

COP--COP-Colombian peso. N.A.--Not available. N/A--Not applicable. N.M.--Not meaningful.

Ratings Detail (As Of February 1, 2012)

Banco Davivienda S.A.

Counterparty Credit Rating BBB-/Watch Neg/A-3

Counterparty Credit Ratings History

25-Jan-2012 BBB-/Watch Neg/A-3

28-Oct-2011 BBB-/Stable/A-3

Sovereign Rating

Colombia (Republic of)

Foreign Currency BBB-/Stable/A-3

Local Currency BBB+/Stable/A-2

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard

Ratings Detail (As Of February 1, 2012) **(cont.)**

& Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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