CONFERENCE CALL SCRIPT
BANCOLOMBIA’s 3Q16 RESULTS

FORWARD LOOKING STATEMENT DISCLOSURE; NON-GAAP MEASURES DISCLOSURE

OPENING REMARKS

RESULTS SUMMARY
(Slide 2)

JUAN CARLOS MORA: Good morning everyone. It is a pleasure to be here with you today to share the development of the bank during the third quarter.

During the quarter, we generated 604 billion pesos in net income, which represents an annualized ROE of 12.4%.

The evolution of the business during this quarter was positive and in line with our expectations. The figures for the quarter confirm our forecast and the trends observed in previous quarters. Operational metrics such as loan growth, net interest margin and income, fee revenue and efficiency continued evolving very well. Despite an increase in provisions charges, attributable to individuals and SMEs, the Net Interest Income after provisions grows in a very positive way compared to one year ago.

As a matter of fact, if we analyze our revenues, net of provisions: that is Net interest Income Plus Fee Income minus provision charges, we can see a 29% year on year growth as compared to the 3Q15. For the first nine months of 2016, the figure is 25% higher than one year ago. This shows the excellent performance of our operations and shows the Bank’s competitive advantages.

Our operation in Central America continues evolving according to our plan. Today, they represent a challenge due to the complex political and economic situation, in particular in El Salvador. Nevertheless we see opportunities for increasing the profitability and the efficiency and as a result, a bigger contribution to Bancolombia’s consolidated returns. In particular, we are focused in improving the processes in Banistmo in Panamá, integrating the operation in BAM in Guatemala and maintaining the profitability in Banco Agrícola in El Salvador. On the other hand, Bancolombia Colombia is making extraordinary progress in achieving efficiency levels not seen in the last five years.

As we had seen during the first half of the year, a moderation in the pace of economic activity continues. Nevertheless, we have also seen dynamism in certain sectors, such as construction, manufacturing and services, which continue to improve as the domestic economy remains resilient and benefits from a weaker currency. The peso and the exchange rate have presented a relative stability, although after the elections in the US we have seen increased volatility.

Our results for the quarter put us on our way of achieving superior ROEs and I will reiterate the bank’s focus and commitment to generate desirable and sustainable levels of profitability. I would like to also emphasize that increasing profitability in all geographies added to boosting efficiency will be the two fundamental drivers going forward to reach our performance objectives in the stipulated time periods.

In addition to the financial performance, we wish to emphasize four aspects of our strategy.
1st) More relevance of our retail business in the composition of our revenues, especially in the Net Interest Income. This is an effort to improve profitability by better selecting our risks and allocating capital to assets that generate higher risk-adjusted returns.

2nd) Focus on efficiency, by optimizing our processes and systems and implementing very strict cost control strategies.

3rd) Innovation, as the avenue for engaging more customers in Bancolombia’s network in an efficient and profitable way, and finally,

4th) Increase in the profitability of our international operations. We already have the set-up, the market, now we are working on improving the processes and improving the profitability of each of the operations in

Additionally, I wish to mention a very relevant topic, this time regarding our distribution channels.

Today, Bancolombia has the largest distribution network in Colombia, El Salvador and Guatemala. In particular, in Colombia, where the population is spread across the country and our large network of branches and ATM permits to target all type of clients. The main advantage of this coverage is that it permits to have the lowest funding cost and the most stable funding structure in the whole system. Nevertheless, we acknowledge that having such a massive infrastructure is expensive. The balance of both advantages and expenses is positive for our universal banking strategy.

With this in mind, we are gradually shifting our transactions from the classical branch to other channels with little or no marginal cost, such as mobile or internet.

Today, Bancolombia processes 48% of the total transactions of the Colombian system, more than two times the market share that we have in loans. Additionally, out of the total number of transactions that Bancolombia processes, 68% are conducted through internet and mobile devices, this compares to 47% of the whole system. This facts represent a competitive advantage of Bancolombia when conducting transactions through low-cost channels and is the cornerstone of our efficiency strategy. The bigger the proportion of transactions through electronic channels, the greater the efficiency of the bank and the bigger the capacity to increase capillarity and monetize the massive amount of relationships that we have with our clients.

That is precisely, our path for the future, to be able to grow our transactions with clients, increase volumes and of course, revenues at the lowest possible cost. The demographics of the geographies where we operate create the perfect condition to take advantage of new technologies in order to attract more individuals to the formal banking sector. The main goal with our digital initiatives is to be able to materialize efficiencies and grow in a sustainable way.

Having said this, I would like to continue with the presentation of Bancolombia’s financial results for the third quarter of 2016. Now, I will turn the presentation over to José Acosta who will elaborate on the main topics that impacted our business in this period, José.

Slide 3

JOSE ACOSTA: Thank you Mr. Mora.
Slide number 3 shows the profitability of the bank.
As you can see, the third quarter shows a 66% growth in profit before taxes as compared to 3T15, which is a terrific evolution of the business. This has been possible thanks to better performance of NIMs, cost control in expenses and fee generation.

The quarter, though, shows a reduction in the profit before tax and in the bottom line as compared to 2T16, caused mainly by higher provision charges that we did during the quarter in order to protect the balance sheet.

Operational metrics, in particular Net Interest Income continue to perform very well as a result of stability in the lending NIM and higher volumes. This expansion in NII has permitted to offset the higher provision charges and for the first nine months of the year, to grow income before taxes by 29%.

Additionally, net fees continue growing at a very good pace, driven by higher utilization of our products and channels.

Regarding taxes, we had an effective tax rate of 38%, in line with our expectations. We forecast an effective tax rate of approximately 39% for the year, assuming a year end FX rate similar to the current one: three thousand and a hundred pesos per dollar. Nevertheless, as we have previously mentioned, the tax rate for the year will be subject to any variation in exchange rates. We will only know the taxes payable at the very last day of the year.

All included, we are very satisfied with these results because they show the strengths of Bancolombia: the ability to fund the bank at the lowest cost in the markets where we operate, the capacity to transfer interest rates to the asset side and the ability to generate capital in an organic manner. Moreover, we take advantage of our strong distribution network (more than 7 million customers in Colombia and 4 in Central America), along with our bank’s strong local capital markets position. We keep paying special attention to the credit quality in order to prevent further deterioration and higher provision charges.

Now, we would like to continue with a brief discussion about the economic environment. For this purpose, we have Juan Pablo Espinosa, Bancolombia’s Chief Economist who will elaborate more on these matters, go ahead Juan Pablo.

**JUAN PABLO ESPINOssa**: Thank you José. Now, I will ask you to go to slide number four (4) in the presentation.

Slide 4

2016 has been a difficult year for Latin America. During the past year some of the major economies in the region have been affected by a combination of international and local challenges. Global factors include a poor performance of external demand, a decrease in foreign trade and declining terms of trade. Internally, several countries have struggled with a weakening of their currencies, inflationary pressures and a deterioration of business and consumer confidence. As a result, the region’s GDP is expected to contract 0.6% this year.

However, we expect economic activity in Latin America to pick up in 2017. Some of the factors behind this recovery will be the dissipation of shocks in commodity markets, a greater margin for authorities to implement
expansionary policies, and the fact that countries such as Brazil and Argentina will operate in a more constructive political landscape. Hence, the region is expected to grow 1.6% in 2017. It is worth mentioning that this and next year Central America will expand by 4%, well above Latin America’s average.

Despite this constructive outlook, it is important to bear in mind that risks are biased to the downside. For instance, the results of US presidential elections raise doubts about the future path of the American economy and the way in which the new administration will define its relationship with Latin America. A potential perspective of higher inflation and interest rates in the US, a less dynamic bilateral trade and the implementation of immigration policies that affect remittances flows could affect the economies of the region. Regarding specific countries, we anticipate that next year Colombia will start a recovery cycle that will gain full traction in 2018. Some drivers for a more dynamic internal demand will include the stabilization of terms of trade, the moderation of inflation and an acceleration of private investment. Therefore, in our baseline scenario growth will accelerate from 2% the year to 2.6% in 2017 and 3.4% in 2018.

In terms of prices and interest rates, we foresee that the deceleration in inflation that has taken place during the past few months will persist thanks to a normalization of food supply and to the weakness in aggregate demand. Thus we expect that inflation at the end of the year will be 5.9% and by December 2017 will be around 3.9%. Eventually this will lead to an easing cycle in the monetary policy. However, the Central Bank’s recent communications have been marked by a hawkish tone. This can imply that the start of rate cuts could take longer than initially expected.

Based on our growth and inflation expectations, we anticipate that loan growth in Colombia will start to recover by the second half of next year. In the case of Panama, latest activity indicators point to a mild moderation in growth this year to approximately 5%. This reflects the sensitivity of the Panamanian economy to global growth and trade conditions. Nevertheless, activity will strengthen in 2017 to a 5.6% GDP growth due to investment in mining, logistics and infrastructure and an expansionary fiscal policy.

In El Salvador, our perspectives point to a steady expansion of economic activity. During this year private consumption has been expanding rapidly, and this will lead to a 2.3% growth this and next year. Finally, in Guatemala we expect activity to expand in 2016 close to the country’s potential rate which is around 3.5% and to pick up in 2017 to 3.8% due to higher investment and stable interest rates.

[JUAN PABLO ESPINOSA: After this overview of the economic environment, let me turn the presentation to Jose Humberto Acosta, who will discuss the Bank’s results.]

JOSE: Thank you, Juan Pablo.

Slide 5

On slide 5, we see the evolution of assets and their composition.

Some important facts about Bancolombia’s assets and loan portfolio
- Today, peso denominated loans represent 63% of the total portfolio of Bancolombia (and is organically growing at 12%), while dollar denominated represents 37%. Also, the COP appreciated 1.3% against the USD during the second quarter and 7% over the last twelve months.
- Loans outside Colombia represent 28% of the total book.
- Our loan portfolio in USD, expressed in dollar, decreased 15% over the last year due to lower demand of USD financing in Colombia, and finally,
- All the products are growing in line with our expectations and forecast.

Total assets grew 9.3% yoy, in line with our organic target rate of 10% growth for the year.

Loan portfolio growth is primarily driven by mortgages and commercial loans which continue to exhibit sustained growth around 10% for the year. Nevertheless, we start to see the positive impact of seasonal effects on consumer credit demand and towards the end of September, we experienced acceleration in this product, with 13% YoY growth.

In this segment, consumer loans, we focused our strategy in targeting high income individuals and segments with low indebtedness levels as a way to growth with lower risk in these clients. The main input for our scoring models is the track record of the client along with the payment capacity.

The average yield to maturity for the investment portfolio is 6.7% and we continue to maintain a structural debt portfolio primarily for liquidity management. Also, the duration of the securities portfolio continues to remain low at 17.8 months, which minimizes risks in a very volatile environment.

We continue originating loans with strict underwriting standards, in order to maintain the high credit quality of the loan portfolio, especially in the consumer and SME segments.

The loan portfolio in USD decreased during the last twelve months, affected by the FX rate we just mentioned and by a moderation in credit demand. The loan portfolio is growing less than what we saw in 2015, which is perfectly fine and in line with our risk and credit standards, since the Colombian economy will be growing around 2% in 2016, and 2.6% in 2017.

We see some opportunities in sectors such as manufacturing, tourism and infrastructure. Many of these sectors have been positively impacted by the weak peso. That is why we maintain our growth forecast for 2016 to 10%. We will still focus our growth in the less risky products as we want to maintain a very healthy balance sheet.

Last, but not least, we want to highlight a fact that is very important to understand our view on capital. That is the high regulatory capital consumption of all our assets. The proportion of risk weighted assets plus market risk to total assets is 87%, a ratio that is very high and also gives us comfort because the risk weightings are very conservative in the Colombian regulatory framework.

Slide 6

Now on slide 6, we present the snapshot of the credit quality at the end of the quarter.

We saw a deterioration in the quality of the loan portfolio and the coverage ratio for C, D & E loans. The SMEs and the consumer book, in particular credit cards and car loans, were the main contributors of the past due loan formation.

As a result of the deterioration, 30 day past due loans to total loans ended at 3.4% and the coverage ratio declines to 116%

We forecast to have a 30 day coverage ratio ranging from 110% to 120% in the medium term, which we believe is more than enough to absorb potential credit losses. Similarly, 30 day PDLs should represent between 3.2% and 3.5% of gross loans.

At the bottom of the table, we compare 30-day past due loans, which is the Colombian standard, and 90-day past due loans which is a better indicator of credit quality as we have a significant portion of our assets in
countries that use that standard. The run off of some past due loans that were past due 30 days three months ago causes the 90 day ratio to increase to 2.2%.

Slide 7

Slide number 7 shows the provision charges, which were 791 billion COP during the quarter. For the first nine months, the annualized cost of risk has been 1.8%

In the shaded row of the table at the bottom, we present the amount of loans that became 30-day past due during the quarter.

The COP 892 billion new past due loans is a significant increase as compared to the previous quarters and a reason to be careful with the portfolio. Most of the new PDLs came from the consumer segments, in particular credit cards and car loans.

In the corporate side, we have not had any particular problem with a sector or client. Regarding the issue with Grupo Wisa and Waked, we are glad to say that despite the problems that the client faced in Panamá, all the banks, the Panamanian government and the US treasury worked out a solution to create a Special Purpose Vehicle that is collecting the payments and serving the banking obligations. As a result we do not estimate to have any loss related to these loans, which are financing basically commercial real estate assets.

As we have talked about in recent months, the Central Bank hiked rates at the beginning of the year and we are now stable at an all-time high. This trend translated positively into better margins but did have a negative effect over growth of the broader economy. Delinquencies are on a rise and the bank must decide between growing less or otherwise taking on more risk. We believe we have a sufficient amount of risk appetite and have not made a change to our initial strategy from the beginning of the year.

We will continue monitoring the performance of the portfolio and making sure that the new vintages are disbursed under more stringent underwriting standards.

Our forecast for cost of risk in 2017 is 1.8 to 1.9%

Slide 8

Moving on to slide number 8, we see the evolution of net interest income (NII) and funding costs along with funding composition.

As we had seen in the second quarter, this is the most positive trend in our business because over the last twelve months, we have been able to grow NII much faster than the volumes of loans, and as a result, the operating income of the bank has grown steadily as well. This is a combined effort on two fronts: first, optimizing the funding terms and structure in order to keep costs as low as possible and second, pricing loans at higher spreads.

NII for Q16 was 2.5 trillion COP, 42% greater than the same quarter of the previous year, driven by

- Higher loan volumes, which grew 11% over the last year.
- Higher spread on new originations, both in Pesos and in dollars.
- The 191 basis points increase in the DTF, which is the benchmark rate that we use to price a significant portion of our loans. And as a result, an improvement in NIMs.
- The evolution of the Libor has had a positive impact in the dollar lending NIM.

Bancolombia’s funding cost was slightly pressured upwards mainly by higher costs on long term debt and time deposits. This is the outcome of the Central Bank’s interest rate hikes and a relatively tighter liquidity environment that has increased funding competition among banks.
The retail deposit base in our foreign operation has also performed in a very positive way, as we keep our asset sensitive condition and the stability of these deposits remains.

The total funding cost increased by 34 basis points during the quarter while the Central Bank’s reference rate increased 25 basis points and the DTF increased 18 basis points.

During this year we have focused our efforts not only on keeping the funding cost as low as possible, but also on increasing the average time to maturity of the stock of liabilities, in particular time deposits and Long Term Debt. The outcome of this strategy has been the stability in the lending NIM that we saw in the third quarter. Our goal is to keep funding costs as low as possible, which we have been able to achieve over the past months, while maintaining a conservative approach to liquidity risk management, in an effort to defend or expand the NIM and grow NII. We have in our favor the before mentioned asset sensitive condition of our balance sheet which is beneficial for margins.

Slide 9

Turning the page to Slide number 9, we show the Net Interest Margin.

During 3Q16, we saw a light increase in the reported Net Interest Margin to 6.2%, 10 basis points above last quarter’s, explained by the investments net interest margin.

In particular, three main factors positively impacted the investments NIM during the quarter:

1) The appreciation of Colombian Treasury’s (or TES) and some other securities, even though the investment portfolio is only 7% of total assets.
2) Investments flows, mainly from international player entering the Colombian fixed income market.
3) More clients demanding structured products for hedging purposes, such as FX swaps, options, etc.

In the lending business, we saw stability of the NIMs as the interest rate hike cycle seem to have little effects in the re-pricing of the balance sheet.

Due to the asset sensitive condition of Bancolombia’s balance sheet, we intend to reduce our sensitivity to potential interest rate cuts that we could see in the first months of 2017. This is intended to maintain the NIM as high as possible for a long as possible.

Colombia shows the strongest NIMS because of the repeated rate hikes during the quarter, while NIMS in Central America are significantly lower. At the end of the quarter, we had an unconsolidated NIM for Colombia of 7.1%, compared to 3.9% in Banistmo, 6.5% in Banco Agricola (a very positive number in our view), and 5.5% in Guatemala for Banco Agromercantil’s operation. Despite the lower numbers in Panama and Guatemala specifically, we did benefit substantially from the higher NIM environment in Colombia.

For 2017, we see challenges in the NIM and NII front, as we forecast interest rate cuts in Colombia in the first months of the year. Nevertheless, the NIM from USD loans should benefit from potential hikes from the FED.

We are designing our plans for next year and are focusing our efforts in keeping the deposits at low cost as possible, in particular: savings accounts as a vehicle for our clients to keep their money in the systems, current accounts which benefit from our transactional capacity and CDs as a mechanism to provide stability of funds and enhance the maturity profile.

Slide 10

A breakdown analysis of Fees is presented on slide number 10.

Fees are another front where we continue making progress, as can be seen in recent results.
During the third quarter Net fees increased by 3.4% and they grew 15.2% as compared to the third quarter of 2015. Of this annual growth, BAM contributes with 3.2%.

The main services and products that lead the fee growth, were banking and ATM services as well as debit and credit cards fees. We are experiencing sustained growth in cards and usage in Colombia, due to rising income of individuals and also the promotion of plastic as a method of payment.

We continued to see more credit and debit cards transactions, as a result of our commitment to promote the use of electronic methods for in-store transactions. In addition, we’re tapping into new business segments when it comes to promoting and introducing numerous benefits and customer rewards initiatives.

Today, Bancolombia has 25% market share of the system billing and 18% of the number of cards outstanding in the Colombia.

Banking services and asset management were also a major contributor for fee growth during the quarter, as well as asset management.

In addition, we saw a sustained performance of insurance distribution fees, which generated 75 billion COP during 3Q16, and grew 26% year over year.

Fees represented 17% of 3Q16 operating income, which is a good share since these are transactions that do not require a significant amount of capital compared to lending.

These fee initiatives are not limited to Colombia, and we are focusing on steadily growing the credit card segments in El Salvador, Guatemala and Panama.

As Mr. Mora mentioned at the beginning of the presentation, Bancolombia has an indisputable relevance in transactions in the Colombian banking system. Since 2011, we have been gaining market share of the number of the transactions executed in the Colombian banking sector. We went from 37% in 2011 to 48% in 2015. During the same time frame, our market share of loans has ranged from 21% to 24%.

The actions that permitted these gains are part of our strategy to use electronic channels as the path to interact with more individuals and corporations.

We look forward to continue being the leader in the payments system and to monetize this important competitive advantage.

Finally, we forecast a fee growth of around 10% in 2016.

Slide 11

Now, moving to slide 11, we present the evolution of expenses.

Total operating expenses grew 12% year over year or 173 billion COP. When analyzing this growth in marginal terms, we find that BAM represented 64% of the increase. In other words, excluding BAM, the yoy growth would have been 4.2%.

Excluding BAM, the cumulative operating expenses as of September grew 10.3% compared to the first nine months of 2015, a figure that put us in our designed path for the year.

The cost to income ratio improved significantly QoQ because of ongoing cost control initiatives and strong NII growth, and was 47% in 3Q16. Our target is to maintain this number under 50% for the year in the short term.

Operating expenses consist primarily of personnel expenses and administrative expenses which have been kept under control in their respective currencies.
As we stated last quarter, Bancolombia is committed to developing lower cost channels, based on technological innovation and optimal customer segmentation, as we strive to grow expenses in line with nominal GDP.

Our guidance for 2016 is an increase of expenses by 8 to 10% on an organic level, which we believe will be key in obtaining strong profitability levels.

Slide 12

Moving on to slide 12, we see the evolution of the net loans and deposits, which have moderated the pace of growth in recent months.

The net loan to deposit ended the quarter at 115%, slightly below the figure shown last quarter. This ratio has become relatively stable over the last year and is a level where we feel comfortable.

The proportion of loans that we do not fund with deposits is funded with long term debt in order to have a similar duration in both sides of the balance sheet. This strategy reduces the volatility in the net income and shareholders’ equity. It makes more sense to us, to fund long term loans with long term liabilities and that’s why the 115% is a level that gives us comfort about the liquidity position of the bank.

Regarding capital, on the bottom right hand side, we show the Capital Adequacy ratio. The Tier 1 ended at 9.05%, 455 basis points above the regulatory minimum of 4.5%. This is a very good ratio and most importantly, the continuous growth in the metric leads us to re affirm our estimation that 2016 will be a year of capital accumulation. If we consider a dividend pay-out of one third and appropriate the remaining portion of the earnings, we estimate that in March 2017, we could see a Tier 1 ratio close to 9.5%.

Nevertheless, as we have shared with you in the past calls, the capital levels that Bancolombia present today are optimal for the business plan that we have designed, in particular, we identify four factors to support our thesis:

1) First, The Colombian regulation is very conservative, and the risk weightings of assets is very high. Nevertheless, Bancolombia is well above the regulatory capital level and that fact give us comfort.
2) Secondly, the simple leverage of Bancolombia is very low.
3) Third, when we run our models to estimate the economic capital required to operate the bank, we find that the requirement is to have a Tier 1 of 4.4%, which is very similar to the regulatory requirement.
4) Fourth, we have 22% of our equity is in dollars, which mitigates the impact of the depreciation of the Colombian peso on risk weighted assets.
5) Finally, given the business cycle that we are going through today, we do not see the need to have more capital. The credit growth forecast for this year is very moderate and we will organically generate the capital to achieve that growth. We do not plan to pursue more M&A opportunities in the coming years as we are focused in the optimization of our operations in Central America.

As we have said before, we look to operate the bank at an optimal Tier 1 ranging from 8 to 9%
For the Tier 2 ratio, we ended 3Q16 with 4.4% for a total BIS ratio of 13.5%, above the regulatory threshold of 9%.

Slide 13

Slide number 13 shows the ROA and ROE of the bank.

The ROE for the quarter was 12.4% and ROA was 1.3%. This metrics were impacted by the combined effect of very good revenues, net interest income and fees, but also higher provision charges.
We expect to continue growing net income, although at a moderate pace, while maintaining solid solvency indicators for the rest of the year and improving profitability.

Our estimated ROE for 2016 is 12%, while the medium term target continues to sit at 16%.

RECAP AND FINAL MESSAGE:

After presenting these results to you, we wish to re-affirm two main goals for the future:

1) First, our focus on profitability. This will come from a combined effect of moderate growth in our lending business and stability in NIMs.
2) Second, our focus on efficiency. This is a necessary condition to sustainability and profitability. The 47% that we posted this quarter is very good and we expect to operate below 50% in the coming years.
3) Third, capital generation. We are building up equity as we generate profits and allocate better our assets.
4) Four, optimization of our international operations through process optimization and efficiency, and
5) Fifth, innovation as a key element to increase our market and reduce expenses.

After presenting these slides and discussing our third quarter results, I would like to invite our audience to ask any questions you might have and we'll gladly take it from there.

Questions And Answers

First question
Thiago Batista, Analyst Itau BBA.
Yeah. Hi, guys. Thanks for the opportunity, and thanks for a very complete presentation. I have two follow-up questions. The first one about margins. You already mentioned that the interest rate in Colombia will probably decline in '17 in this scenario, and after a very positive performance of margins in '16. Do you believe it's possible to see margins relatively flattish next year, or is more likely to see some decline in the margins? And the second question is about tax, I know that you already mentioned that the tax probably would be around 39% this year, but do you have any guess for the level of tax in '17. I know that there is a lot of moving parts, but do you have any view on the tax in '17?

Jose Humberto Acosta, Chief Financial Officer
Thank you, Thiago. Regarding your first question, yes, we see a challenge for the next year regarding how to sustain the NIM. Our focus right now will be to maintain the funding cost under control. Our sensitivity is for every 100 basis points that we change, the interest rate will be reduce or increase our NIM 9 bps. Based on that assumption, I'm assuming that the interest rate goes down will be maybe the compression of the NIM at around 10 basis points. But again, next year, also, you'd see a huge potential of augmenting the funding cost under control. If you double check and compare us with the other institutions, we today are able to have the lowest level of funding cost. So the answer is, we'll try to maintain at the same level, but we will see a slightest reduction the second half of 2017 in 10 basis points. Regarding your second question with the tax -- taxation and our statutory tax. We are modeling the next year with a tax at around 38% to 40%.

Second question
Nicolas Riva, Analyst Citi
Yeah. Thanks Jose Humberto for taking my question. The first one on asset quality, if you can explain what happened really this quarter, because we saw an increase of 20 basis points overall in the NPL ratio for the whole Bank. And we saw increases in all three segments, commercial 20 basis points, Consumer 30 basis points, mortgages 10 basis points. If you can explain what happened in the third quarter on NPLs? And also, what's the outlook for the NPL ratio fourth quarter and next year? And the second question on capital, which I believe was one of the main positive highlights on the quarter. The improvement in capital, Tier 1 ratio increased 60 basis points quarter-on-quarter 9.1% now. Now I understand that Colombian banks capitalize return earnings only once a year and that happens in the first quarter, which is going to be first quarter next
year. So then, what really explain the improvement in capital, and if it was mainly really just the fact that the risk-weighted assets were about flat quarter-on-quarter? Thanks.

Jose Humberto Acosta, Chief Financial Officer
Thank you, Nicolas. Regarding the asset quality, there are several factors that affect the deterioration of the loan portfolio. First, the vintage of the consumer loan book that we generate last year behaving in a different way, and right now, we are adjusting those scoring models, but that was the first reaction. We saw an increase of deterioration, because of that, the vintages of credit -- consumer credits originated the last year. Second, there are some corporate loans that impacted the deterioration of the loan portfolio. And the Panamian operation also has an increase in credit cards operation and consumer loans, that was impacted, and that's the reason why you see an increase of deterioration of the loan portfolio. Our guidance in cost of credit as I mentioned at the beginning is today, we believe that this year-end, we'll close with a cost of credit of 1.8, and next year, we will be the stabilization of this cost of credit and the range will be 8.7 to -- 1.7 to 1.9. And this is basically, because interest rates will go down, the GDP as you hear from Pablo will increase to 2.6. So we see a better environment for loan portfolio next year. Regarding your second question on quality. We are allocated in a best way our securities portfolio, that's the reason why, our solvency ratio is increasing, and we are trying to increase the capital level. That's the main reason, why it is explained that increasing the BIS ratio. Yes, in March, we will benefit of the regained earnings, and you'll see on the legal reserves, and the number again will be at around 9.5% at the end of this year.

Third question
Tito Labarta, Analyst Deutsche Bank
Hi, good morning, and thanks for the call. Actually, my question is on the tax rate, again, just more on the fiscal reform that some has been mentioned. Just could you give us the latest update on that? And what would that mean for your corporate tax rate beyond 2017, if that approved? I think there's a big reduction in the corporate tax rate. Could you give us any update where that stands and how that would impact you? Thank you.

Jose Humberto Acosta, Chief Financial Officer
Thank you, Tito. Yes, we are on every stage regarding the tax reform, but our perception is it's very -- it is positive regarding -- because it's oriented to individuals, including the VAT, increasing the VAT. Our Chief Economist has mentioned previously that probably the best way to put in place that fiscal reform or tax reform will be doing a step-by-step increase in the VAT gradually for the next three years. We see an opportunity reducing the corporate tax, and we, the counterpart of that probably we'll increase in the level of investments in Colombia that will help to the economy to increase the activity to maintain unemployment and rates under control. So again, the perception is positive Tito, but it is still early to give some clear guidance depends on the conversations and discussions in the Congress. But again, it is -- we see positive, but that this is a mandatory tax reform, not only because of the fiscal deficit or the oil price, it is because the government needs to increase the tax base in individuals and to reduce the tax base for corporates.

Fourth question
Jason Mollin, Analyst Scotiabank
Hi, everyone. I have a follow-up on the asset quality evolution. We did see deterioration in the segments that you talked about, but one thing is we -- when we look at the sector numbers or the banking system numbers in general for Colombia, it appears on certain metrics that Bancolombia's numbers deteriorated more. Are you seeing that? And what do you think drove that, if that is in fact the case? Thank you.

Rodrigo Prieto Uribe, Chief Risk Officer
Hi. This is Rodrigo Prieto speaking. Regarding the financial system in Colombia, we have -- the last two years, we went to different segments. Those segments are low income segments that I can divide the answer into two. The first one is that, it comes by the margin, because even though, the loss is higher than the results in the margin are seeing right now. And there are some that we saw that deterioration last year, we thank the credit policies this year, exactly now to launch in May, and we had others in June. And the last ones we did in September. So I think that in cost of credit, we are in the peak by now. I don't know, how -- exactly how the...
loss is for the future. I consider that in five or six months, we are going to see the decrease in the cost of credit. So if we compare, it's exactly what you are seeing, but we are in other segments, that the comparison with other banks is not appropriate in consumer portfolio, because every bank in Colombia is different in the segments that we have.

Jose Humberto Acosta, Chief Financial Officer

The key message here is, this is not taken by surprise for us, the provisions that we are having now. If you remember in our previous conference calls, we announce that in the first quarter for example, cost of credit were very low. And we have the number, and we expected to get that number, I mean the 1.8%. And the message that the revision in its, this is maybe the big that we are gaining in terms of past-due loans and the numbers will be at least flattering for the next coming quarters or even reduce depends on the behaving of the economy.

Fifth question

Ernesto Gabilondo, Analyst Bank of America

Hi, good morning, Jose Humberto, and everybody, and thanks for taking my call. So only one question. I believe the Colombian banking regulator will follow Basel III. As such, I would like to know to what extent Bancolombia will be aligned with the new capital standards? And if you are considering to incorporate a systemic buffer as other banks or systemic banks should have aligned with Basel III in 2018? Thank you.

Jose Humberto Acosta, Chief Financial Officer

Thank you, Ernesto. Yes, we have an internal team here analyzing the implications of the Basel III, and we are also in early discussions with the regulator. Yes, we have two or three different fronts. The first one is the buffer for provisions. If you see, we have also 200% -- almost 200% of provisions of 90-day past-due that will be a kind of buffers that you're having on the asset side, instead of having of the equity side.

So we believe that with the regulators, we will have conversation regarding that. How to transfer from the asset side to the equity side, regarding provisions and buffer for provisions. Regarding the systemic buffer, we know that the numbers could range from 0.5% to 2% to compare with the Chilean model. So we are running from models try to realize what will be the number for 2018 regarding Basel III. And no matter what the number we'll get, that today minimum level is 4.5, assuming that they will increase 150 basis points -- sorry 200 for systemic buffers. We are still complaining the level of Q1.

So we don't have any specific concern, but again, we are also defining how will be implemented this Basel III term for sure, we've implemented in tranches. So we will have time to maintain and to grab some new capital.

Sixth question

Andres Duarte, Analyst Corficolombiana

Hello. Good morning. Thank you for the presentation. And my question is about Bancolombia's U.S. dollar proprietary position. So Colombia Central Bank gave us a deadline, the 5th of July to correct the existing proprietary position corresponding to goodwill and the application of IFRS. This excess is about or adds up to about $1.3 billion, and the goodwill part is related to acquisitions made by the major Colombian banks in Central America. So I would like to know what's your opinion on that? And what's the portion of this excess in position that corresponds to Bancolombia? And how do you plan to correct it as the deadline is 5th of July? Thank you very much.

Jose Humberto Acosta, Chief Financial Officer

Andres, thank you for your question. Yes, this is a very technical question regarding proprietary position. You know that the regulation in Colombia is contemplated some adjustments, because the banks in Colombia is acquiring international operations, and we are funding them in a different way. So if you want to give you a very detailed answer, we can call you during the morning, because again this is a very technical, because this is basically, because of the accounting system, which is -- which accounts or which lines of the accounting system you have to take in consideration to calculate the proprietary position.

But we are again, working and talking with the regulators and with the Minister of Finance and with the Central Bank regarding how to adapt this number to the new environment and the new structure of the banking industry. We will call you for sure during the morning Andres.
Seventh question
Maria Barriga, Analyst Davivienda Corredores
Hello. Thank you very much for taking my call. I was wondering about your operations in Central America, specifically in El Salvador, where recently a rating agency downgraded its BCA. So I was wondering, if you could expect any impairment on these operations. Thank you.

Jose Humberto Acosta, Chief Financial Officer
Thank you, Maria. Salvador is one of the most -- our most efficient operation, the return on equity there is at around 15%. We are the number one there with 30% of market share. So I would say that, yes, that impacted the price of the bonds that we issued two years ago, but we are not feeling impacted -- any particular impact regarding funding cost, regarding cost of funding cost. So we are not seeing a deterioration of the bank in the country, because again, the performance there is very good. We are still growing at a pace of 2% to 3%. We are still maintaining the market share, and if you double check the numbers for the first half of this year, we are almost close to 60% of the total net income of the financial system. So again, we don't foresee any specific deterioration in our Salvador operation. The other way around, as we seen explain at the beginning of the speech, Banco Agricola is growing. We have replicated the same experience with projects there. We are growing very, very healthy way in fees, we are growing with new products as a leasing operation. We are doing a lot of things in Salvador, and it's working very well.

Eight question
Catalina Araya, Analyst JPMorgan
Yes. Good morning. I was just wondering, I think in terms of expenses, you guys are delivering good growth, less than 5%, despite higher inflation in the country. What's the expectations for next year? And what's the long-term goal in terms of efficiency? Thank you.

Jose Humberto Acosta, Chief Financial Officer
Thank you, Catalina. Yes, as you can see, this is the number that we feel proud, because the last 5 years, we are doing our job regarding reduction in expenses in the local operation and international operation. Our guidance and you know that this is very, very key for us. If we want to recover our return on equity, the level of the efficiency it has to be below 50%, and we will expect for the next 2 years to get a level of 48% of efficiency ratio. How we will do that? If you double check the numbers, in our Colombian operation, our efficiency level is at around 44% --45%. So as Juan Carlos explained at the beginning, that would be key to become more efficient international operations. We have to do a lot of things there in the three operations, probably (inaudible) on every stage, we have to implement a lot of systems, we have to implement a lot of procedures, but the way to get the 48% the next two years would be doing through our international operations. So we have to do a lot of things there. Increasing the income, the fees, increasing the NII, but also maintain under-controlled expenses.

Ninth question
Sebastian Gallego, Analyst Credicorp.
Hi, good morning, everyone. Thanks for the call. Just a follow-up on the last question. You mentioned the room for improving efficiency in the -- within Central America, but can you expand more on the specific strategy that you want to implement in those countries, particularly in Panama and Guatemala on the expense side? Thank you.

Jose Humberto Acosta, Chief Financial Officer
Okay. Thank you, Sebastian. Efficiency is a combination of the both sides of the equation. What we are planning to do? In Panama, for example, we are experiencing a growth of NII, because we are growing our loan portfolio, we are increasing the fees. So that will help the efficiency level on the income side. Also, we will try to replicate the same in Guatemala. On the cost side, remember that we spend a lot of money on Banistmo operation the first two tiers implementing the software. Right now, we are seeing a kind of plateau in terms of expenses. So we expect to see a reduction of expenses the next two or three tiers. Same, we’re having with the Banco Agromercantil operation in Guatemala. So we would expect to reduce the level of efficiency from 65% at least to 60% in Bank Agromercantil. But again, the efficiency level in those
operations will be focusing the two sides of the story, increasing the income and trying to maintain control -- cost control.

Tenth question

**Natalia Casas, Analyst Ultraserfinco**

Hi, thank you for the call. I'm kind of worried about the asset quality of the Bank, because this is like there was the number that you have shown under IFRS. And so I like to know, if you have any guidance about the PDL ratio for this and the next year? And what -- how are you going to reduce this indicator to PDL ratio? Thank you.

**Jose Humberto Acosta, Chief Financial Officer**

Thank you, Natalia. Yes, Natalia, yes, the level as I mentioned is quite high this quarter. But if you compare for the whole year, the number is it's under [ph]12, which is just [ph]1.8% of cost upgrade. But regarding the guidance, we will expect the level of past-due loans will be at around 3.2% to 3.3% the year, and we would expect same level for the next year, assuming a GDP growth of 2.6%, because we don't see clearly the impact of the tax reform. So that's the reason, why our guidance is to maintain the same level of past-due loans for 30-day.

**Operator**

Thank you. That is all the time that we have for questions. I would like to turn the call over to Mr. Mora for final remarks.

**Juan Carlos Mora, Chief Executive Officer**

We would like to thank everybody to attending this conference call. I will end with some final remarks. I know that you are concerned about asset quality, we are following very closely the development of our loan portfolio.

We are sure that our development in the rest of the year is going to improve. During the quarter, there have been some specific issues related basically to the upgrade of our credit card platform that didn't allow us to have enough information to do collections in the right way. That has an impact -- that's a situation that is solved already. So we are expecting that by the end of the year, the asset quality is going to be in line of our expectation. Another focus is taxation. We need to work on how to improve the taxation that, because it's impacting the net income of the Bank, because there we saw the operational results are very good, taxation is impacted. And also, we expect that the third quarter is going to be positive for the results of the Bank.

Again, thank you very much for attending this conference call, and we expect you to be with us on the conference call that we will have to present the results of the year 2016. Thank you very much, and have a good day.