Rating Action: Moody's downgrades Bancolombia's sub debt and BCA; affirms senior ratings

New York, November 08, 2016 -- Moody's Investors Service today downgraded Bancolombia S.A.'s standalone baseline credit assessment (BCA) and adjusted BCA to ba1, from baa3, and its long-term foreign currency subordinated debt to Ba2, from Ba1. At the same time, Moody's affirmed the bank's long- and short-term global local and foreign currency deposit ratings of Baa2 and P-2, respectively, and long-term foreign currency senior unsecured debt rating of Baa2 with a stable outlook.

Moody's also affirmed Bancolombia's long- and short-term Counterparty Risk Assessment of Baa1(cr) and Prime-2(cr).

Issuer: Bancolombia S.A.

The following ratings and assessments have been downgraded:

.... Subordinate Regular Bond/Debenture, to Ba2 from Ba1
.... Adjusted Baseline Credit Assessment, to ba1 from baa3
.... Baseline Credit Assessment, to ba1 from baa3

The following ratings and assessments have been affirmed:

.... Senior Unsecured Regular Bond/Debenture, Baa2
.... Long Term Local and Foreign Currency Deposit Rating, Baa2
.... Short term Local and Foreign Currency Deposit Rating, P-2
.... Long Term Counterparty Risk Assessment, Baa1(cr)
.... Short term Counterparty Risk Assessment, P-2(cr)

....Outlook, Remains Stable

RATINGS RATIONALE

Moody's downgraded Bancolombia's standalone BCA to ba1, from baa3, to incorporate the bank's greater exposure to less developed, and in some cases increasingly risky, operating environments in Central America.

The downgrades follow the downgrade on 7 November 2016 of the El Salvador's government's bond rating to B3, from B1, in line with increased liquidity risks facing the government stemming from its persistently high and rising short-term debt and the legislative impasse that has so far this year prevented the approval of long-term debt issuance to retire short-term paper. (For more information, see Moody's press release titled "Moody's downgrades El Salvador's government bond ratings to B3 negative, concluding review for downgrade").

Bancolombia owns El Salvador's largest bank, Banco Agrícola, S.A., the assets of which represented 7% of the parent's total, as of June 2016.

The deterioration of the country's institutional strength and increase in government liquidity risk reflected by the downgrade of the Salvadoran sovereign prompted a reassessment of the country's Macro Profile to "Very Weak +," from "Weak." As a result, Moody's lowered Bancolombia's weighted Macro Profile, which also considers the bank's exposures to Panama and Guatemala, to "Moderate," from "Moderate +," the Macro Profile for Colombia. The bank's Macro Profile reflects the riskiness of the operating environments to which Bancolombia is exposed and provides the context within which its financial profile is assessed.

The downgrade of El Salvador and the reassessment of its macro profile comes on top of a substantial
increase of Bancolombia's relative exposure to Central America over the last 18 months, to one-third of assets as of June 2016, from just over a quarter as year-end 2014, as a result of the depreciation of the Colombian peso since mid-2014 and the consolidation of the bank's Guatemalan subsidiary, Grupo Financiero Agromercantil (unrated), the holding company of Banco Agromercantil de Guatemala, S.A. (BAM, unrated) in December 2015. Guatemala, which has a "Weak" Macro Profile, now accounts for another 7% of Bancolombia's exposures. However, the bank's largest Central American operation is Banistmo, S.A. (unrated), the second largest bank in Panama, which has a "Moderate" Macro Profile. Banistmo accounts for about 20% of Bancolombia's total assets.

The downgrade of the BCA also considers the bank's low adjusted capitalization, and hence loss absorption capacity, which declined substantially in recent years. As a result of significant increases in intangibles and risk-weighted assets (RWAs) due to the depreciation of the Colombian peso, tangible common equity (TCE) has fallen to just 6.2% of fully adjusted RWAs as of June 2016. From 2014, the bank's reported Tier 1 ratio is relatively modest at just 8.5%. However, Moody's expects a modest rebound in capital due to slowing loan growth and reduced capital consumption. Notwithstanding the decrease in capital and increased exposure to higher risk operating environments, the BCA continues to be supported by the bank's proven earnings generation capabilities, broad access to core funding, and good asset quality.

Despite the downgrade of the BCA, Moody's nevertheless affirmed Bancolombia's deposit and senior unsecured debt ratings at Baa2 to reflect the very high probability that Bancolombia will receive government support in a situation of financial stress, which now results in two notches of uplift from the bank's ba1 BCA. The bank's subordinated debt rating, which does not benefit from government support was downgraded in line with the BCA. The sub debt is notched down from the BCA to reflect lower expected recovery in the event of a bank failure given its lesser priority of claim.

The stable outlook considers Moody's expectation that the bank's key financial indicators will prove resilient to the slowdown in economic growth in Colombia.

What Could Change the Rating Up or Down

While Bancolombia's outlook may be stable, the BCA and ratings are nevertheless weakly positioned at current levels and are vulnerable to further downward pressure in the event of a relatively modest but sustained deterioration of the bank's financial fundamentals. Specifically, the BCA could be downgraded if nonperforming loans rise above 2% of gross loans, or if the bank's capitalization remains below 6.5% and loan loss reserve coverage falls below 2-times nonperforming loans. If the BCA is lowered to ba2, the debt and deposit ratings would likely be lowered as well, notwithstanding public support.

The BCA is unlikely to face upward pressure unless the bank's TCE/RWAs rises above 9%. Even if the BCA increases, however, Bancolombia's deposit and senior unsecured debt ratings are unlikely to be affected because they are at the same level as Colombian government's bond rating.

The principal methodology used in these ratings was "Banks" published in January 2016. Please see the Rating Methodology page on www.moodys.com for a copy of this methodology.

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