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CREDIT OPINION
14 August 2020

Update

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RATINGS

Banco de Reservas de la Republica Dominicana

Domicile	Santo Domingo, Dominican Republic
Long Term CRR	Ba3
Type	LT Counterparty Risk Rating - Fgn Curr
Outlook	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	B1 / Ba3
Type	LT Bank Deposits - Fgn Curr / Dom Curr
Outlook	Stable

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 Reservas de la Republica Dominicana

Update to credit analysis

Summary

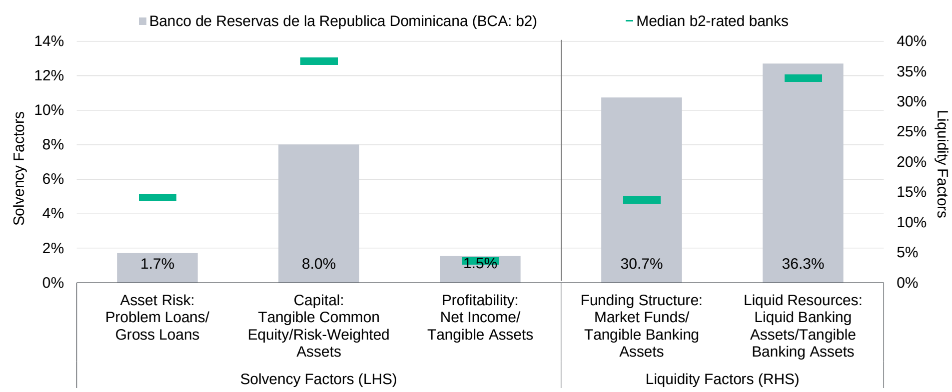
We assign a Baseline Credit Assessment (BCA) of b2 to Banco de Reservas de la Republica Dominicana (Banreservas), which is 100% owned by the Government of the Dominican Republic (DR, Ba3 stable). The BCA incorporates Banreservas' continued good asset quality and profitability, solid access to inexpensive retail deposit funding and ample liquidity buffers. These credit strengths help balance the bank's historically weak adjusted capitalization.

Banreservas' Ba3 local-currency deposit rating is at the level of the DR's rating, and it receives two notches of uplift from the bank's b2 BCA because of our assumption of full government support. This assumption is based on the government's full ownership of the bank, the close financial and business links between the two, and the importance of the bank's deposit and lending franchise.

Exhibit 1

Rating Scorecard - Key financial ratios

Historical scorecard ratios as of March 2020



For the asset-risk ratio and profitability ratios, we review the latest three year-end ratios, as well as the most recent intra-year ratio, where applicable, and base our starting point ratio on the weaker of the average of this period and the latest reported figure. For the capital ratio, we use the latest reported figure. For the funding structure and liquid resources ratios, we use the latest year-end figures.

Source: Moody's Financial Metrics

Credit strengths

» Strong profitability on the back of an ample net interest margin (NIM), as well as moderate provisions and low taxes

» Stable deposit funding and good liquidity, which balance the short-term liability maturities

» Historically strong asset quality

Credit challenges

» Expected deterioration in asset quality driven by the coronavirus pandemic

» Weak core capitalization

» The DR's operating environment for banks, as measured by its Macro Profile of Weak+

Outlook

The outlook on Banreservas' deposit ratings is stable, in line with the outlook on the DR's Ba3 government bond rating.

Factors that could lead to an upgrade

Banreservas' deposit ratings could be upgraded in case of an upgrade of the DR's sovereign rating. However, the bank's BCA and its subordinated debt rating could face upward pressure if it maintains strong asset-quality metrics, and hence profitability, despite the continued rapid retail growth, or if the DR's operating environment for banks improves further.

Factors that could lead to a downgrade

Banreservas' deposit ratings would be downgraded in case of a downgrade of the sovereign rating. While the BCA could be downgraded in the case of a sudden deterioration in asset quality and profitability, a significant increase in the transfer of earnings to the government or a large decline in liquidity, this would not affect the bank's rating.

Key indicators

Exhibit 2

Banco de Reservas de la Republica Dominicana (Consolidated Financials) [1]

	03-20[2]	12-19[2]	12-18[2]	12-17[2]	12-16[2]	CAGR/Avg.[3]
Total Assets (DOP Million)	579,054.3	570,493.7	505,388.5	463,425.3	456,326.8	7.6[4]
Total Assets (USD Million)	10,691.5	10,691.4	10,110.8	9,575.9	9,844.2	2.6[4]
Tangible Common Equity (DOP Million)	35,276.6	29,196.1	25,163.0	25,354.8	23,064.9	14.0[4]
Tangible Common Equity (USD Million)	651.3	547.2	503.4	523.9	497.6	8.6[4]
Problem Loans / Gross Loans (%)	1.7	1.4	1.5	1.8	1.4	1.6[5]
Tangible Common Equity / Risk Weighted Assets (%)	8.0	6.9	6.9	6.8	7.0	7.1[6]
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	12.0	12.8	14.6	15.5	13.6	13.7[5]
Net Interest Margin (%)	7.0	6.7	6.7	6.4	6.3	6.6[5]
PPI / Average RWA (%)	4.7	3.9	3.4	3.4	3.1	3.7[6]
Net Income / Tangible Assets (%)	1.7	1.6	1.4	1.4	1.4	1.5[5]
Cost / Income Ratio (%)	63.0	68.9	71.3	70.4	74.2	69.6[5]
Market Funds / Tangible Banking Assets (%)	30.5	30.7	35.3	35.8	40.9	34.6[5]
Liquid Banking Assets / Tangible Banking Assets (%)	42.0	36.3	33.0	32.4	31.9	35.1[5]
Gross Loans / Due to Customers (%)	100.9	111.8	126.8	130.5	143.8	122.7[5]

[1] All figures and ratios are adjusted using Moody's standard adjustments. [2] Basel I; LOCAL GAAP. [3] May include rounding differences because of the scale of reported amounts. [4] Compound annual growth rate (%) based on the periods for the latest accounting regime. [5] Simple average of periods for the latest accounting regime. [6] Simple average of Basel I periods.

Sources: Moody's Investors Service and company filings

Profile

Banreservas is the DR's largest bank, accounting for about one-third of the system's assets. The bank offers a wide range of financial products, including loans, deposits, insurance, pension fund management and underwriting services. Banreservas mostly focuses on commercial and public-sector lending. Commercial loans to the private sector comprised 48% of the bank's loan book as of March 2020, followed by consumer loans (24%), mortgages (15%) and loans to public entities (13%).

The bank is 100% controlled by the Dominican State, and it reported total assets of $10.7 billion as of March 2020.

Recent developments

Reflecting the growing strain of the coronavirus-pandemic induced disruption, our outlook for Central American banking systems is negative, in line with our overall outlook for Latin American banking systems, capturing our view that the disruption related to the coronavirus pandemic will exacerbate an existing slowdown in the region's economic growth. This will increase the strain on the region's banks' operating environments and will erode their asset quality. The authorities' broad supplemental policy actions will provide support to banks' liquidity, and their adequate capitalization will help buffer stress losses. However, the recovery will likely be relatively more muted in the region than in advanced economies, in which case the credit-negative implications for banks will intensify. We expect the greatest negative credit effects to particularly affect undiversified banks with exposures to regions most acutely disrupted or with concentrated lending to the most affected sectors, as well as more thinly capitalized banks and non-bank lenders.

The rapid global spread of the coronavirus has led to a deteriorating economic outlook, sharply lower oil prices and broad financial market upheaval, generating an unprecedented credit shock across many sectors worldwide. Our baseline economic scenario assumes pandemic-driven disruption of economic activity through June, followed by some recovery in the second half of 2020. However, that outcome will depend on whether governments can reopen their economies while also safeguarding public health. A rebound in demand will determine the ability of businesses and labor markets to recover from the shock.

The Dominican Republic's Government, the Central Bank and the Superintendency of Banks have implemented several measures that involve the banking system in order to address the economic impact of the pandemic, including a reduction of minimum reserve requirements for banks that lend to households and small companies at capped interest rates, forbearance for the recognition and provisioning of problem loans, interest rate reduction and introduction of liquidity lines for banks both in local and foreign currency.

Detailed credit considerations

Expected deterioration in asset quality driven by the pandemic

Despite relatively rapid loan growth in recent years -in line with the DR's GDP growth and decelerating in 2020- asset risks have remained contained, as illustrated by a low level of nonperforming loans (NPLs) and thick reserve coverage of soured credit. Total NPLs were at 1.7% of gross loans as of March 2020, up slightly from 1.6% a year earlier, while loan-loss reserves were strong at about 1.9x problem loans.

Key risks for credit quality include the expected deterioration in the loan portfolio for the rest of the year due to the economic downturn caused by the coronavirus pandemic. The bank has implemented different measures to respond to the weak economic environment, such as deferral programs and interest rate and fee reductions. We expect loan growth to be limited in 2020 given our forecast of a 1.5% contraction in the DR's economy, down form our pre-coronavirus expectation of 5% growth, although we think the economy will rebound to 4% next year given a gradual recovery in tourism and other exports.

In addition, risks may arise from previous rapid credit growth in the inherently risky consumer segment in the past few quarters, coupled with still-very-high borrower concentrations in both the public and private sectors. After a 16% year-over-year increase as of March 2020, consumer loans account for 24% of the total loan book, while the consumer NPL ratio was at a still manageable level of 2.7% as of March 2020, higher than the metric for the overall portfolio. At the same time, the 20 largest loan exposures comprise about 1.2x the bank's tangible common equity (TCE).

Because of the significant dollarization of the balance sheet, Banreservas is also exposed to credit and market risks stemming from currency mismatches. As of March 2020, net foreign-currency loans represented about 20% of total loans. The bank increased its positive net foreign-exchange position considerably to 18.9% of TCE in March 2020 from 1.2% in December 2019.

Strong profitability on the back of an ample NIM, as well as moderate provisions and low taxes

Banreservas' robust profitability, supported by an ample NIM and low albiet rising credit costs, provides a key buffer against potential deterioration in asset quality. In the first three months of 2020, return on assets was at 1.7%, higher than the 1.4% reported in the first quarter of 2019. Moreover, NIM improved to 7.0% as of March 2020 from the 6.3% reported for Q1 2019 mainly due to decreasing average funding costs, supported in turn by an increase of less expensive demand deposits' share on total funding.

On the other hand, credit costs increased in 2019 after a decline in 2018. Following this uptrend, in the first three months of 2020, the bank reported a 70% increase in provisions from a year earlier, reaching 1.2% of gross loans, from 0.7% as of March 2019. The increase in provisions was partly driven by the expansion of consumer loans. Unlike consumer credit, government loans, as well as credit to some power-generating and road infrastructure endeavors, are not required to be provisioned. In addition, Banreservas' fee income has been rising gradually and contributed 17% of net revenue for the first three months of 2020.

Operating efficiency continues to represent a challenge, with relatively high operating costs, which consumed about 63% of net revenue. Likewise, operating costs were at 6.0% of total assets in Q1 2020, slightly up from the 5.9% presented as of March 2019. Finally, the bank is exempted from income tax, although it voluntarily pays some taxes. The effective tax rate was about 9% as of March 2020.

The key risks to the bank's profitability include potentially rising credit costs because of asset risk pressures arising from the pandemic, as well as increasing exposures to the consumer sector, although the latter are likely to be offset by higher margins.

Weak core capitalization

Banreservas' core capitalization remains weak. The achievement of the paid-in capital goal of DOP10 billion in 2016 was offset by large dividend payments in 2017-18 of above 60% of net income, in line with Banreservas' organic law. The latter mandates that 35% of earnings must be retained, 15% must be used to repay the government's outstanding debt with the bank and 50% may be distributed as dividends after paying at least 5% of the National Treasury's outstanding bonds.

While Banreservas' regulatory total capital ratio remains strong at 16.7% of risk-weighted assets, this ratio benefits from non-tradable government bonds that the government has used to capitalize the bank in the past and a zero risk weight accorded to the bank's holdings of government securities and to loans to the public sector. Our preferred TCE ratio, which adjusts for these factors, was at around a much more modest 8.0% as of March 2020, providing limited loss absorption of unexpected credit or investment losses. The ratio, however, improved from the 7.5% reported as of March 2019 because of a rise in retained earnings.

Stable deposit funding and good liquidity balance the short-term liability maturities

Because of its status as the largest bank in the country and its state ownership, Banreservas also benefits from superior access to low-cost deposits. While the bank's reported market funds were at 30% of its total assets as of March 2020, if time certificates of deposits (valores en circulación) were deducted from market funds, the metric would have declined to 6%, indicating limited refinancing and repricing risks. These time certificates of deposits are reportedly equal to time deposits. The key difference is currency; time certificates of deposits are largely denominated in Dominican pesos, while time deposits are denominated in US dollars.

However, the deposit base is concentrated, with the top 20 deposits representing 37% of the total deposits, while about a quarter of total deposits and time certificates of deposits are held by the public sector. In addition, the bank's funding structure is significantly skewed toward short-term maturities, reflected by the fact that more than half of its total liabilities are due in less than 30 days. However, as of March 2020, 81% of total deposits comprised core deposits (demand deposits and savings accounts), which tend to be sticky, allowing for a better match of the longer-term loan book.

Liquidity remains thick and has recently improved in line with the growth of the deposit base and more subdued loan growth, with liquid banking assets representing 42% of tangible banking assets, chiefly constituting government securities and deposits at the central bank.

Banreservas credit profile is influenced by the DR's Weak+ macro profile

Dominican Republic´s Weak + macro profile reflects a long history of dynamic growth, with GDP expanding at a robust average annual rate of more than 5% since 2002, despite slightly decelerating in 2019, and GDP per capita above peers'. However, the severe decline in tourism and the impact on domestic consumption as a result of social distancing and quarantine measures following the coronavirus outbreak will significantly affect the country's economic growth. Although improving, institutional strength remains weak, as reflected by the country's still low scores on the Worldwide Governance Indicators.

Notwithstanding still low financial intermediation, bank credit has grown substantially in the last few years. Nonperforming loans have remained relatively low, although we expect an increase due to the virtual halt of economic activity in the country due to the pandemic and the widespread impact of lower remittances and exposures to the tourism sector. The highly concentrated banking system provides the country's leading banks strong pricing power, while stable deposits and ample liquidity buffers support financial flexibility.

ESG considerations

Banreservas' exposure to environmental risks is low, consistent with our general assessment for the global banking sector. See our environmental risk heat map for further information.

Overall, we view banks as facing moderate social risks. The most relevant social risks for banks arise from the way they interact with their customers. Social risks are particularly high in the area of data security and customer privacy, which is partly mitigated by sizable technology investments and banks' long track record of handling sensitive client data. Fines and reputational damage because of product mis-selling or other types of misconduct are further social risks. Social trends are also relevant in a number of areas, such as shifting customer preferences toward digital banking services increasing information technology costs, aging population concerns in several countries affecting demand for financial services or socially driven policy agendas translating into regulations that affect banks' revenue base. See our social heat map for further information.

Governance is highly relevant for Banreservas, as it is to all participants in the banking industry. Corporate governance weaknesses can lead to a deterioration in a bank's credit quality, while governance strengths can benefit its credit profile. Governance risks are largely internal rather than externally driven, and for Banreservas, we do not have any particular governance concerns. Nonetheless, corporate governance remains a key credit consideration and requires ongoing monitoring.

Support and structural considerations

Government support

The Ba3 local-currency deposit rating is based on the b2 BCA and, hence, incorporates two notches of uplift because of our assumption of full government support, given the government's 100% ownership of the bank and the close financial and business links between the bank and the government, as well as the importance of Banreservas' deposit and lending franchise as the country's largest bank. The bank's B1 foreign-currency deposit rating is constrained by the sovereign ceiling for foreign-currency deposits.

The B2 foreign-currency subordinated debt rating reflects a lower probability of government support for the bank's subordinated debt than for its deposits because the purpose of this instrument is to absorb losses.

Counterparty Risk (CR) Assessment

CR Assessments are opinions of how counterparty obligations are likely to be treated if a bank fails and are distinct from debt and deposit ratings in that they (1) consider only the risk of default rather than both the likelihood of default and the expected financial loss, and (2) apply to counterparty obligations and contractual commitments rather than debt or deposit instruments. The CR Assessment is an opinion of the counterparty risk related to a bank's covered bonds, contractual performance obligations (servicing), derivatives (for example, swaps), letters of credit, guarantees and liquidity facilities.

Banreservas' CR Assessment is positioned at Ba3(cr)/NP(cr)

The CR Assessment, before government support, is positioned one notch above the Adjusted BCA of b2 and, therefore, above the deposit rating, reflecting our view that its probability of default is lower than that of deposits. We believe senior obligations represented by the CR Assessment will be more likely preserved to limit contagion, minimize losses and avoid disruption of critical functions.

The CR Assessment also incorporates our assumption of full government support, in line with our support assumptions on deposits. This reflects our view that any support provided by government authorities to a bank that benefits deposits is very likely to benefit operating activities and obligations reflected by the CR Assessment as well, consistent with our belief that governments are likely to maintain such operations as a going concern to reduce contagion and preserve a bank's critical functions.

Counterparty Risk Ratings (CRRs)

CRRs are opinions of the ability of entities to honor the uncollateralized portion of non-debt counterparty financial liabilities (CRR liabilities) and also reflect the expected financial losses in the event such liabilities are not honored. CRR liabilities typically relate to transactions with unrelated parties. Examples of CRR liabilities include the uncollateralized portion of payables arising from derivatives transactions and the uncollateralized portion of liabilities under sale and repurchase agreements. CRRs are not applicable to funding commitments or other obligations associated with covered bonds, letters of credit, guarantees, servicer and trustee obligations, and other similar obligations that arise from a bank performing its essential operating functions.

Banreservas' CRRs are positioned at Ba3/NP

The CRR, before government support, is positioned one notch above the Adjusted BCA of b2 and, therefore, above deposit ratings, reflecting our view that CRR liabilities have a lower probability of default than the bank's deposits because they will more likely be preserved to limit banking system contagion, minimize losses and avoid disruption of critical functions.

The CRR also incorporates our assumption of full government support, in line with our support assumptions on deposits.

Methodology and scorecard

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.

Rating methodology and scorecard factors

Exhibit 3
Banco de Reservas de la Republica Dominicana

Macro Factors		
Weighted Macro Profile	**Weak +**	**100%**

Factor	Historic Ratio	Initial Score	Expected Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	1.7%	ba1	←→	ba3	Single name concentration	Loan growth
Capital						
Tangible Common Equity / Risk Weighted Assets (Basel I)	8.0%	b3	←→	caa1	Capital fungibility	
Profitability						
Net Income / Tangible Assets	1.5%	ba1	←→	ba2		
Combined Solvency Score		ba3		b1		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	30.7%	b2	←→	ba3	Deposit quality	Term structure
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	36.3%	ba1	←→	ba2	Quality of liquid assets	
Combined Liquidity Score		ba3		ba3		
Financial Profile				b1		
Qualitative Adjustments				Adjustment		
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				0		
Total Qualitative Adjustments				0		
Sovereign or Affiliate constraint				Ba3		
BCA Scorecard-indicated Outcome - Range				ba3 - b2		
Assigned BCA				b2		
Affiliate Support notching				0		
Adjusted BCA				b2		

Instrument Class	Loss Given Failure notching	Additional notching	Preliminary Rating Assessment	Government Support notching	Local Currency Rating	Foreign Currency Rating
Counterparty Risk Rating	1	0	b1	1	Ba3	Ba3
Counterparty Risk Assessment	1	0	b1 (cr)	1	Ba3(cr)	
Deposits	0	0	b2	2	Ba3	B1
Dated subordinated bank debt	-1	0	b3	1		B2

[1] Where dashes are shown for a particular factor (or sub-factor), the score is based on non-public information.
Source: Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
BANCO DE RESERVAS DE LA REPUBLICA DOMINICANA	
Outlook	Stable
Counterparty Risk Rating	Ba3/NP
Bank Deposits -Fgn Curr	B1/NP
Bank Deposits -Dom Curr	Ba3/NP
Baseline Credit Assessment	b2
Adjusted Baseline Credit Assessment	b2
Counterparty Risk Assessment	Ba3(cr)/NP(cr)
Subordinate	B2

Source: Moody's Investors Service

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