

CREDIT OPINION

25 June 2018

Update

✓ Rate this Research

RATINGS

Domicile	Guatemala City, Guatemala
Long Term CRR	Not Assigned
Long Term Debt	Not Assigned
Long Term Deposit	B3
Type	LT Bank Deposits - Fgn Curr
Outlook	Positive

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 los Trabajadores

Update following upgrade

Summary

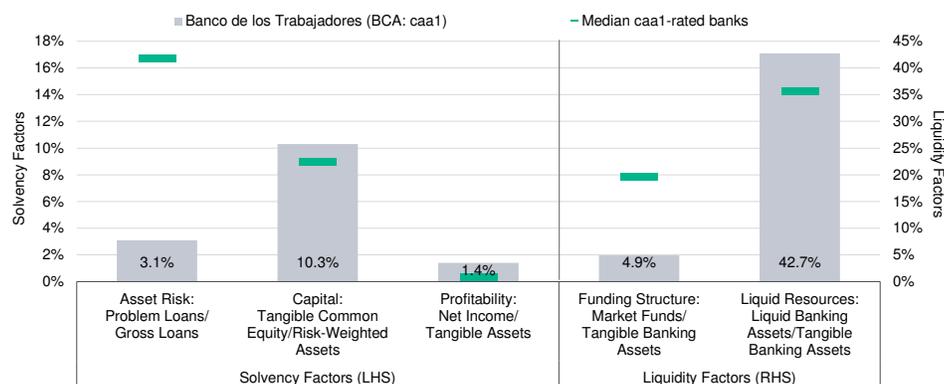
On 18 June 2018, we upgraded¹ [Banco de los Trabajadores](#)' (Bantrab) standalone Baseline Credit Assessment (BCA) and Adjusted BCA to caa1 from caa2, as well as the bank's long-term deposit rating to B3 from Caa1. We also upgraded [Bantrab Senior Trust](#)'s (BST, a Cayman Islands-based trust guaranteed by Bantrab) backed foreign-currency senior unsecured debt rating to Caa1 from Caa2. The outlook on both Bantrab and BST's ratings remains positive.

The rating action reflects the reduction in the bank's international payment risks because its payment mechanisms are repeatedly tested and proved following the loss of the bank's previous correspondent banking relationships (CBRs). The upgrade also captures a steady improvement in Bantrab's capital, which more than offsets a recent decline in the bank's profitability and a gradual deterioration in its asset quality. The positive outlook incorporates our view that international payment risks are likely to continue to decline, in line with an initiative launched in 2017 to strengthen the bank's corporate governance and improve risk management and control practices.

Exhibit 1

Rating Scorecard - Key financial ratios

Bantrab's data as of March 2018



Source: Moody's Financial Metrics

Credit strengths

- » Still-strong profitability, despite the bank's narrowing net interest margin (NIM) and weak efficiency
- » Asset quality supported by the bank's preferential creditor status

Credit challenges

- » Diminished, although still elevated, external payment risks
- » Moderate capitalization, which provides a limited buffer to absorb unexpected losses
- » Ratings constrained by Guatemala's Weak Macro Profile

Outlook

The positive outlook incorporates our view that international payment risks are likely to continue to decline in line with an initiative launched in 2017 to strengthen the bank's corporate governance and improve risk management and control practices.

Factors that could lead to an upgrade

In line with the positive outlook, the ratings could eventually be upgraded again if the bank is able to obtain additional CBRs or otherwise demonstrate a continuous decline in its international payment risks, while further strengthening its risk management controls to avoid a recurrence of its recent corporate governance shortcomings. If these measures are not successful, however, the outlook could be stabilized.

Factors that could lead to a downgrade

If Bantrab were to lose either its sole remaining CBR or its arrangement with the local brokerage house, thereby increasing the risk that it may not be able to make any payment related to BST's global bond or other obligations in a timely manner, its ratings could be lowered again. The bank's ratings could also be lowered in case of any further disclosure of corporate governance flaws.

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

Key indicators

Exhibit 2

Banco de los Trabajadores (Consolidated Financials) [1]

	3-18 ²	12-17 ²	12-16 ²	12-15 ²	12-14 ²	CAGR/Avg. ³
Total Assets (GTQ million)	22,936	21,611	18,283	16,945	14,144	16.0 ⁴
Total Assets (USD million)	3,100	2,942	2,430	2,220	1,861	17.0 ⁴
Tangible Common Equity (GTQ million)	2,015	1,543	1,101	838	638	42.5 ⁴
Tangible Common Equity (USD million)	272	210	146	110	84	43.7 ⁴
Problem Loans / Gross Loans (%)	3.1	2.9	2.7	2.4	1.3	2.5 ⁵
Tangible Common Equity / Risk Weighted Assets (%)	10.3	8.4	6.5	5.4	4.9	7.1 ⁶
Problem Loans / (Tangible Common Equity + Loan Loss Reserve) (%)	16.3	18.8	19.3	18.0	12.5	17.0 ⁵
Net Interest Margin (%)	6.8	7.4	7.1	8.5	9.3	7.8 ⁵
PPI / Average RWA (%)	2.0	3.6	3.5	3.2	3.9	3.2 ⁶
Net Income / Tangible Assets (%)	1.4	2.3	2.5	2.6	2.2	2.2 ⁵
Cost / Income Ratio (%)	73.2	61.1	62.0	65.9	63.7	65.2 ⁵
Market Funds / Tangible Banking Assets (%)	4.9	5.2	6.3	7.1	9.2	6.5 ⁵
Liquid Banking Assets / Tangible Banking Assets (%)	42.7	40.4	37.3	44.8	38.2	40.7 ⁵
Gross Loans / Due to Customers (%)	68.2	71.5	76.1	65.2	74.2	71.0 ⁵

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

Source: Moody's Financial Metrics

Profile

Banco de los Trabajadores (Bantrab) is the sixth-largest bank in Guatemala, with \$3.1 billion in consolidated assets as of March 2018, coupled with loan and deposit market shares of 7.3% and 8.2%, respectively, as of April 2018. The bank is focused mainly on unsecured consumer lending to public-sector employees under the aegis of a preferential creditor status according to the bank's Organic Law.

Bantrab's capital is widely held, with 99% of it owned by around 700,000 Guatemalan shareholders. The remaining 1% is retained by the Guatemalan state, which allows the president of the republic to appoint the bank's president.

BST is a Cayman Islands-based trust established for the sole purpose of acquiring a 100% participation interest in a senior unsecured loan granted by [Deutsche Bank AG, London Branch](#) (senior unsecured Baa2 negative) to Bantrab to secure the bond issuance governed by New York Law. The payment of principal and interest is absolutely, unconditionally and irrevocably guaranteed by Bantrab.

Detailed credit considerations

Diminished, although still elevated, external payment risks

Bantrab's international payment risks have reduced as its payment mechanisms are repeatedly tested and proved following the loss of the bank's previous CBRs. These mechanisms, which have now been successfully used to make four consecutive coupon payments, include an international CBR with a foreign bank and a local brokerage house. The bank depends on these mechanisms to transfer funds for BST's coupon payments to the bond trustee.

However, Bantrab is still challenged to further diversify its access to international CBRs. Management claims that it is actively seeking new CBRs with US- and Europe-based banks, which, if achieved, will diversify Bantrab's payment channels and reduce its exposure to the loss of any one of the correspondent lines. Unless and until these redundant CBRs are put in place and the new arrangement with the brokerage house is more fully tested, external payment risks will remain elevated.

Bantrab has also been taking steps toward improving its corporate governance framework and controls. Since 2016, when the bank lost the last of its earlier CBRs, it has replaced most of its senior management and will have a new board of directors starting August 2018. Furthermore, the aforementioned developments have not led to a material deterioration in the bank's other financial fundamentals thus far. Bantrab maintains a large store of liquid assets on its balance sheet, with a ratio of liquid banking assets to tangible banking assets of around 43% as of March 2018. The bank's liquidity is chiefly in the form of required liquidity reserves at the central bank and Ba1-rated government securities. The latter provides the bank with financial flexibility in the event of a funding squeeze.

Moderate capitalization provides a limited buffer to absorb credit and investment losses

Although Bantrab's core capitalization has improved owing to an increase in capital reserves, it remains moderate in the light of high loan growth in the past years despite a relatively moderate payout ratio. As of March 2018, the bank's tangible common equity stood at around 10.3% of risk-weighted assets, compared with 8.4% and 6.5% as year-end 2017 and 2016, respectively. We weigh government securities at 100% (as prescribed by Basel for Ba-rated sovereigns), and deduct intangibles and goodwill. The seized preferred shares, amounting to GTQ157 million, were not included in the calculation of tangible common equity because they have nondeferrable payment features.

Strong profitability despite a narrowing NIM and weak efficiency

In 2017, Bantrab reported a robust net income of 2.3% of tangible assets, well above the system average of 1.4%. However, profitability decreased significantly in the first quarter of 2018, although to a still good 1.4% compared with the 2.4% average posted in 2016 and 2017. The decline in earnings is chiefly explained by a change in accounting regimes as of year-end 2017, which prescribes the accrual of lending-related fees according to the maturity of the credit rather than doing it upfront when the loan is originated. As a result of this change, the bank's NIM declined to 6.8% as of March 2018 from 7.4% in 2017.

Lower earnings are also explained by an increase in loan-loss provisions to 39% of pre-provision income as of March 2018, from a two-year average of 8%, due to accounting policy changes. At the same time, returns are also hampered by the bank's weak efficiency, measured as the cost-to-income ratio, which stood at a high 73% as of March 2018.

Asset quality supported by the bank's preferential creditor status

Bantrab's asset quality benefits from its preferential creditor status (for example, payment preference in relation with other authorized deductions) according to its Organic Law. The key risk to asset quality is hefty loan growth in the past years, especially amid the current economic deceleration in the country. In 2015-17, gross loans grew 16% on average, although as of March 2018, loan growth slowed down to 11% from March 2017. Nonperforming loans (NPLs) rose 16% in absolute terms during the same period to 3.1% of gross loans, from 3.0% as of March 2017 and 2.7% as of year-end 2016, and above the 2.5% system average. The increase in NPLs is explained by changes in the policy of problem loans netting against reserves. At the same time, the bank's reserve coverage declined to 100% of NPLs and 3.1% of gross loans, from 132% and 3.95% as of March 2017, respectively.

The bank's existing business links with the government increase its asset risks. The president of the republic directly appoints the chairman of the bank's board.

Bantrab's ratings are constrained by Guatemala's Weak Macro Profile

Guatemala has experienced steady economic growth over the past several years, but the country still has a low GDP per capita and exhibits weak human development indicators. Monetary and fiscal institutions are strong, but institutional strength remains weak overall, particularly in tax administration and rule of law despite the government's fight against corruption, and its effort to improve transparency and accountability. The country also remains susceptible to political event risks related to the ongoing corruption investigations, coupled with high income inequality.

Rapid loan growth and foreign-exchange mismatches in the borrowers' balance sheets represent key risks to Guatemala's currently sound asset quality, supported by a focus on high-quality domestic corporate borrowers. The funding conditions have worsened because international banks' risk aversion toward Central America and the Caribbean has increased, which could result in further reductions in correspondent banking lines and limited access to external funding.

Support and structural considerations

Government support

We believe that there is a moderate likelihood of the [Government of Guatemala](#) (Ba1 stable) providing support for Bantrab's bank deposits. This assessment reflects (1) the fact that Bantrab was established by the Guatemalan government, and (2) the bank's large base of public-sector deposits and significant overall deposit market share of about 8% as of April 2018. Consequently, Bantrab's B3 deposit ratings continue to benefit from one notch of uplift from its caa1 BCA.

On the contrary, we assess a low likelihood of government support for BST's senior unsecured debt obligations owing to the absence of any indication of public support for the bank following the loss of its earlier correspondent lines in May 2016. As a result, BST's Caa1 foreign-currency senior unsecured debt rating is positioned at the level of Bantrab's BCA.

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.

Bantrab's CR Assessment is positioned at B2(cr)/Not Prime(cr)

The CR Assessment, prior to government support, is positioned one notch above the Adjusted BCA of caa1 and, therefore, above deposit ratings, 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 benefits from one notch of government support, in line with our support assumption on deposits ratings. This reflects our view that any support provided by governmental authorities to a bank, which 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.

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 los Trabajadores

Macro Factors

Weighted Macro Profile	Weak	100%				
Factor	Historic Ratio	Macro Adjusted Score	Credit Trend	Assigned Score	Key driver #1	Key driver #2
Solvency						
Asset Risk						
Problem Loans / Gross Loans	3.1%	ba3	← →	b1	Loan growth	Sector concentration
Capital						
TCE / RWA	10.3%	b2	← →	b3	Expected trend	
Profitability						
Net Income / Tangible Assets	1.4%	ba3	← →	ba3	Expected trend	
Combined Solvency Score		b1		b2		
Liquidity						
Funding Structure						
Market Funds / Tangible Banking Assets	5.2%	ba1	← →	b3	Deposit quality	
Liquid Resources						
Liquid Banking Assets / Tangible Banking Assets	40.4%	ba1	← →	ba1		
Combined Liquidity Score		ba1		b1		
Financial Profile						
Business Diversification				0		
Opacity and Complexity				0		
Corporate Behavior				-2		
Total Qualitative Adjustments				-2		
Sovereign or Affiliate constraint:				Ba1		
Scorecard Calculated BCA range				b3-caa2		
Assigned BCA				caa1		
Affiliate Support notching				0		
Adjusted BCA				caa1		

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	b3	1	B2	B2
Counterparty Risk Assessment	1	0	b3 (cr)	1	B2 (cr)	--
Deposits	0	0	caa1	1	B3	B3

Source: Moody's Financial Metrics

Ratings

Exhibit 4

Category	Moody's Rating
BANCO DE LOS TRABAJADORES	
Outlook	Positive
Counterparty Risk Rating	B2/NP
Bank Deposits	B3/NP
Baseline Credit Assessment	caa1
Adjusted Baseline Credit Assessment	caa1
Counterparty Risk Assessment	B2(cr)/NP(cr)
BANTRAB SENIOR TRUST	
Outlook	Positive
Bkd Senior Unsecured	Caa1

Source: Moody's Investors Service

Endnotes

1 Please refer to our press release [Moody's upgrades Bantrab's ratings, outlook remains positive](#).

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