

# Banco Nacional de Costa Rica

## Key Rating Drivers

**Sovereign Support:** Banco Nacional de Costa Rica's (BNCR) ratings are based on the potential support it would receive from the Costa Rican government (B+/Negative Rating Outlook from Fitch Ratings). The bank's IDRs are aligned with the sovereign rating and reflect its explicit guarantee stated in the National Banking System Law and complete ownership by the Costa Rican government.

**Systemically Relevant Bank:** Fitch's support assessment also considers BNCR's high and long-lasting policy role, which would be difficult to transfer, and its systemic importance to the Costa Rican government.

**High Influence of Operating Environment and Company Profile:** We believe that BNCR's Viability Rating (VR) is highly influenced by the operating environment and its company profile, which is marked by a strong franchise and consistent business model, as reflected in its financial performance.

**Leading Franchise:** BNCR is the largest bank in Costa Rica and benefits from its solid franchise, occupying the first position in terms of assets and loans, with a market share of 27.0% and 20.8%, respectively, as of first-half 2019 (1H19). In Fitch's view, this places the bank as a systemically important entity.

**Reasonable Asset Quality:** The non-performing loans (NPL) ratio (+90 days past due) showed an increasing trend from 2016 to 2018, but stabilized at 3.3% at 1H19, due to actions taken by the bank to control asset quality deterioration; however, this compares negatively to the industry average of 2.1% from 2015–1H19. Fitch expects the NPL ratio to remain similar to the 1H19 level.

**Profitability Improving:** As of 1H19, the bank's profitability improved after exhibiting a downward trend in the past several years. Fitch expects the positive trajectory to continue in the medium term due to better operating efficiency and other initiatives. The operating profit to risk weighted assets (RWA) ratio was 1.6% at 1H19, up from 0.7% in 2018 (2016: 1.7%) but compare negatively to that of some peers.

**Appropriate Capital Levels:** Fitch believes the bank's capitalization is appropriate. The Fitch Core Capital (FCC) to RWA ratio averaged 12.4% from 2015 to 2017. However, in 2018, the ratio declined to 11.5%, and, at 1H19, it reversed the trend to reach 12.5% due to measures taken by the entity to continue strengthening its equity position, as well as a small decrease in the RWA.

**Sound Funding Structure:** We believe BNCR's funding structure is solid, with an ample and stable deposit base. Customer deposits accounted for 82.9% of total funding as of June 2019. The entity also has relationships with diverse national and global institutions. At the same date, the loans to customer deposits ratio was 86.8% (industry: 98.1%).

## Rating Sensitivities

Any changes in Costa Rica's sovereign rating may trigger similar movements in BNCR's IDRs, Support Rating (SR) and Support Rating Floor (SRF). Fitch believes the bank's ratings will likely remain aligned with Costa Rica's sovereign rating, considering the sovereign guarantee.

The bank's VR is sensitive to Costa Rica's sovereign rating or material weakening of the operating environment. Additionally, the VR could be downgraded by a material deterioration in asset quality and profitability affecting the FCC to RWA ratio consistently below 9%. Upside potential could only occur in the event of a sovereign upgrade, since this rating is already at the sovereign level.

The bank's senior unsecured debt would mirror any potential change in BNCR's ratings.

## Ratings

### Foreign Currency

|                |    |
|----------------|----|
| Long-Term IDR  | B+ |
| Short-Term IDR | B  |

### Local Currency

|                |    |
|----------------|----|
| Long-Term IDR  | B+ |
| Short-Term IDR | B  |

|                      |    |
|----------------------|----|
| Viability Rating     | b+ |
| Support Rating       | 4  |
| Support Rating Floor | B+ |

### National

|                            |          |
|----------------------------|----------|
| National Long-Term Rating  | AA+(cri) |
| National Short-Term Rating | F1+(cri) |

### Sovereign Risk

|                         |     |
|-------------------------|-----|
| Foreign Currency LT IDR | B+  |
| Local Currency LT IDR   | B+  |
| Country Ceiling         | BB- |

### Outlooks

|   |          |
|---|----------|
| Foreign-Currency Long-Term IDR            | Negative |
| Local-Currency Long-Term IDR              | Negative |
| National Long-Term Rating                 | Stable   |
| Sovereign Long-Term, Foreign-Currency IDR | Negative |
| Sovereign Long-Term, Local-Currency IDR   | Negative |

## Applicable Criteria

[Bank Rating Criteria \(October 2018\)](#)

[National Scale Ratings Criteria \(July 2018\)](#)

[Short-Term Ratings Criteria \(May 2019\)](#)

## Related Research

[Latin American Banks: 1H19 Performance \(October 2019\)](#)

## Analysts

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## Debt Rating Classes

| Rating Level                         | Rating   |
|--------------------------------------|----------|
| Long-Term Senior Unsecured           | B+/RR4   |
| National Long-Term Senior Unsecured  | AA+(cri) |
| National Short-Term Senior Unsecured | F1+(cri) |

Source: Fitch Ratings.

BNCR's senior unsecured debt is rated at the same level as the bank's rating in both international and local scales, as the likelihood of default on the debt is the same as BNCR's. In accordance with Fitch's rating criteria, the recovery prospect in the event of a default of the senior unsecured debt of BNCR is average and is reflected in a Recovery Rating of 'RR4'.

## Ratings Navigator – Stand-Alone Assessment

### Banco Nacional de Costa Rica

ESG Relevance:

|      | Peer Ratings | Operating Environment | Company Profile | Management & Strategy | Risk Appetite | Asset Quality | Earnings & Profitability | Capitalisation & Leverage | Funding & Liquidity | Viability Rating | Support Rating Floor | Issuer Default Rating |
|------|--------------|-----------------------|-----------------|-----------------------|---------------|---------------|--------------------------|---------------------------|---------------------|------------------|----------------------|-----------------------|
| aaa  |              |                       |                 |                       |               |               |                          |                           |                     | aaa              | AAA                  | AAA                   |
| aa+  |              |                       |                 |                       |               |               |                          |                           |                     | aa+              | AA+                  | AA+                   |
| aa   |              |                       |                 |                       |               |               |                          |                           |                     | aa               | AA                   | AA                    |
| aa-  |              |                       |                 |                       |               |               |                          |                           |                     | aa-              | AA-                  | AA-                   |
| a+   |              |                       |                 |                       |               |               |                          |                           |                     | a+               | A+                   | A+                    |
| a    |              |                       |                 |                       |               |               |                          |                           |                     | a                | A                    | A                     |
| a-   |              |                       |                 |                       |               |               |                          |                           |                     | a-               | A-                   | A-                    |
| bbb+ |              |                       |                 |                       |               |               |                          |                           |                     | bbb+             | BBB+                 | BBB+                  |
| bbb  |              |                       |                 |                       |               |               |                          |                           |                     | bbb              | BBB                  | BBB                   |
| bbb- |              |                       |                 |                       |               |               |                          |                           |                     | bbb-             | BBB-                 | BBB-                  |
| bb+  |              |                       |                 |                       |               |               |                          |                           |                     | bb+              | BB+                  | BB+                   |
| bb   |              |                       |                 |                       |               |               |                          |                           |                     | bb               | BB                   | BB                    |
| bb-  |              |                       |                 |                       |               |               |                          |                           |                     | bb-              | BB-                  | BB-                   |
| b+   |              |                       |                 |                       |               |               |                          |                           |                     | b+               | B+                   | B+ Negative           |
| b    |              |                       |                 |                       |               |               |                          |                           |                     | b                | B                    | B                     |
| b-   |              |                       |                 |                       |               |               |                          |                           |                     | b-               | B-                   | B-                    |
| ccc+ |              |                       |                 |                       |               |               |                          |                           |                     | ccc+             | CCC+                 | CCC+                  |
| ccc  |              |                       |                 |                       |               |               |                          |                           |                     | ccc              | CCC                  | CCC                   |
| ccc- |              |                       |                 |                       |               |               |                          |                           |                     | ccc-             | CCC-                 | CCC-                  |
| cc   |              |                       |                 |                       |               |               |                          |                           |                     | cc               | CC                   | CC                    |
| c    |              |                       |                 |                       |               |               |                          |                           |                     | c                | C                    | C                     |
| f    |              |                       |                 |                       |               |               |                          |                           |                     | f                | NF                   | D or RD               |

## Sovereign Support Assessment

BNCR's IDRs, national ratings and senior unsecured debt ratings, both in the local and international market, are based on the potential support the bank would receive from the Costa Rican government (rated B+/Negative). The bank's IDRs are aligned with the sovereign's ratings and reflect BNCR's explicit guarantee stated in the National Banking System Law and complete ownership by the Costa Rican government.

According to the law, the Costa Rican government is responsible for all unsubordinated liabilities of the state-owned banks in the event of the banks' liquidation. In addition, Fitch's support assessment considers the significant and long-term policy role, which would be difficult to transfer, and the systemic importance of the bank to the Costa Rican government.

BNCR's SR of '4' and the SRF of 'B+' reflect the limited probability of support from the Costa Rican government and the current ability of the sovereign to support the bank, despite the bank's important policy role as the largest bank in Costa Rica and the full guarantee from the sovereign. The bank has a market share in deposits of 28.3% on average.

### Bar Chart Legend

Vertical bars – VR range of Rating Factor  
Bar Colors – Influence on final VR  
■ Higher influence  
■ Moderate influence  
■ Lower influence  
 Bar Arrows – Rating Factor Outlook  
↑ Positive ↓ Negative  
↕ Evolving □ Stable

| Support Rating Floor  |          | Value   |          |
|---|----------|---------|----------|
| Typical D-SIB SRF for sovereign's rating level (assuming high propensity) |          | B+      |          |
| Actual country D-SIB SRF  |          | B+      |          |
| Support Rating Floor:   |          | B+      |          |
| Support Factors   | Positive | Neutral | Negative |
| Sovereign ability to support system                                       |          |         |          |
| Size of banking system relative to economy                                |          | ✓       |          |
| Size of potential problem   |          |         | ✓        |
| Structure of banking system   |          |         | ✓        |
| Liability structure of banking system                                     |          | ✓       |          |
| Sovereign financial flexibility (for rating level)                        |          | ✓       |          |
| Sovereign propensity to support system                                    |          |         |          |
| Resolution legislation with senior debt bail-in                           |          | ✓       |          |
| Track record of banking sector support                                    |          | ✓       |          |
| Government statements of support  |          | ✓       |          |
| Sovereign propensity to support bank                                      |          |         |          |
| Systemic importance   |          | ✓       |          |
| Liability structure of bank   | ✓        |         |          |
| Ownership   | ✓        |         |          |
| Specifics of bank failure   |          | ✓       |          |
| Policy banks  |          |         |          |
| Policy role   | ✓        |         |          |
| Funding guarantees and legal status                                       | ✓        |         |          |
| Government ownership  | ✓        |         |          |

## Company Summary

### Sound Franchise with Leadership in Costa Rican Banking Industry

BNCR is the largest state-owned entity in the Costa Rican banking system, occupying first place in terms of assets, with a market share of 27.0% as of 1H19, which places it as a systemically important bank. The participation of gross loans and customer deposits on average was 20.8% and 28.3%, respectively. In Fitch's view, BNCR's leading position in some credit segments and deposit franchise benefit from the sovereign support. As of 1H19, the institution offered its products and services through 162 branches and 464 ATMs, as well as digital banking to benefit its clients.

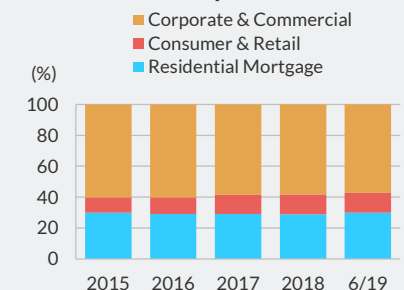
## Key Qualitative Assessment Factors

BNCR has a universal bank business model, in which corporate and mortgage sectors are the most representative. In addition, the entity is in segments such as consumer, enterprises and credit cards. As a development bank, BNCR supports entrepreneurship, SMEs and sustainability projects that foster renewable energy. Also, the bank has diverse funding sources, supported by its strong franchise, combined with debt options in the national and international financial markets.

The lending operations are the BNCR's main source of income. Fitch believes that the bank's business strategy has allowed it to mitigate the earnings volatility through economic cycles. Notably, unlike private banks in the country, an important percentage of BNCR's transactions is denominated in local currency.

We believe BNCR's organizational structure is simple and does not affect the ratings. BNCR is wholly owned by Costa Rica's government. The bank consolidates four regulated subsidiaries, BN Valores Puesto de Bolsa, S.A., BN Vital Operadora de Planes de Pensiones Complementarias, S.A., BN Sociedad Administradora de Fondos de Inversión, S.A. and BN Corredora de Seguros, S.A. BNCR also holds a 49% noncontrolling interest in the Panamanian Banco Internacional de Costa Rica (BICSA), which is rated by Fitch at 'BB-/Negative'.

### Loan Portfolio by Sector



Fuente: Fitch Ratings, BNCR.

## Management with Ample Industry Knowledge

BNCR is managed by its board of directors and its main management team shows an ample degree of market knowledge. The board of directors is composed of seven non-executive members, who, according to the corporate code, are appointed by the government and remain on the board for eight years. However, every four years, three or four members are changed to avoid complete modifications and to continue the bank's strategies.

The entity has good, comprehensive governance policies, which are consistent with those of other state banks in the region. BNCR's corporate governance has multiple levels of supervision, which, in Fitch's view, benefits the creditor interests. The bank also supports its operations with diverse committees; the related-party transactions are not relevant.

Fitch believes BNCR establishes reasonable objectives. For 2019 and 2020, considering the challenging economic environment in the country, the entity plans to expand its loans, focusing on more profitable sectors and financing alternatives with lower costs and longer terms. Also, the entity plans to increase its branch network efficiency to continue reducing its operating expenses. Digital banking and the focus on the customer continue to be part of the bank's strategy. Fitch believes BNCR's execution has been adequate, and the bank has adjusted according to the economic situation.

## Moderate Risk Appetite

According to Fitch, BNCR's risk appetite is moderate, with underwriting standards considered adequate for its operation, since the bank's main risk is related to lending activities. Credit-approval processes are standardized and are monitored through various committees. The bank has strengthened its credit policies and processes to limit risk appetite and tolerance, resulting in more stringent standards. Also, it has continued to work to execute a series of measures, including optimization of the collection management process and calibration of score models. The other credit-risk exposure comes from the bank's securities portfolio. For this risk, the bank has established policies, guidelines and methodologies to manage it.

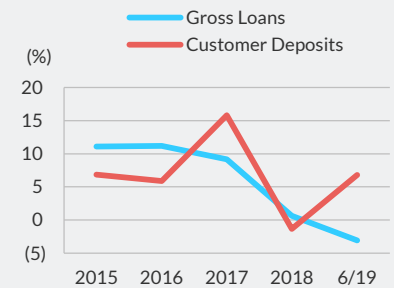
Its risk management framework, manuals, practices, controls and procedures are robust and surpass than those required by regulation. The bank uses a well-structured methodology to define the parameters of tolerance, capacity, appetite and objective for credit, operational, liquidity and market risk. Also, it manages different metrics for its assessment and monitoring. The bank has invested in risk controls and has been very active in advancing and automating its tools. Risk models are internal developments and are validated by an external auditor. Regarding operational risk, Fitch believes its controls are above local standards, which has been reflected in immaterial operating losses as a percentage of annual revenues.

In the past four years, the bank's loans growth exhibited a decreasing trend with an average of 8.0%, similar to the banking system's 8.7%. As of 1H19, as a result of a complicated economic situation, both the entity and the industry declined 3.1% and 3.6%, respectively. Given the environment prevailing, BNCR intends to expand modestly its assets and loans for year-end 2019.

BNCR's market risk is generated fundamentally from interest and exchange rate fluctuations. The bank manages financial derivative instruments, which consist of swaps, futures and forwards. In Fitch's opinion, the interest rate exposure is reasonable and mitigated, given that approximately 94% of the loans are floating rate. Exchange rate risk exposure is moderate, since 70% of loans and 67.2% of customer deposits were denominated in local currency as of June 2019. At the same date, the bank's net position in foreign currency represented 0.7% of FCC.

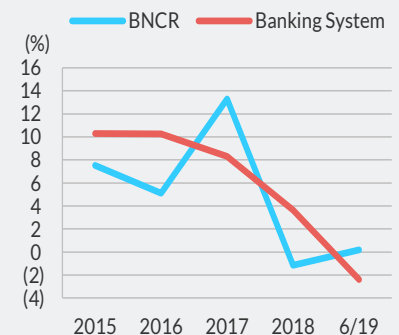
Fitch believes that the management of the trading book is adequate. Interest rate risk is relatively moderate given the size of the portfolio. This risk is mitigated because these securities are fairly liquid, with duration about one year as of June 2019.

## Loans and Deposits Growth



Source: Fitch Ratings, BNCR.

## Asset Growth



Source: Fitch Ratings, BNCR.

## Summary Financials and Key Ratios

| (CRC Mil., Years Ended Dec. 31)           | 6/30/19<br>Six Mos. — Interim<br>Unaudited | 2018<br>Audited    | 2017<br>Audited    | 2016<br>Audited    | 2015<br>Audited    |
|---|--|--------------------|--------------------|--------------------|--------------------|
| <b>Summary Income Statement</b>           |  |                    |                    |                    |                    |
| Net Interest & Dividend Income            | 114,292.2                                  | 260,601.5          | 239,457.1          | 250,344.8          | 220,567.8          |
| Net Fees and Commissions                  | 69,999.5                                   | 135,717.6          | 126,812.5          | 116,553.8          | 107,306.7          |
| Other Operating Income                    | (20,590.7)                                 | (69,868.5)         | (57,496.8)         | (61,826.1)         | (52,354.2)         |
| <b>Total Operating Income</b>             | <b>163,701.0</b>                           | <b>326,450.6</b>   | <b>308,772.9</b>   | <b>305,072.5</b>   | <b>275,520.3</b>   |
| Operating Costs                           | 101,396.3                                  | 208,727.7          | 199,178.2          | 198,973.4          | 196,870.3          |
| Pre-impairment Operating Profit           | 62,304.8                                   | 117,722.9          | 109,594.7          | 106,099.1          | 78,649.9           |
| Loan & Other Impairment Charges           | 30,004.4                                   | 88,526.6           | 71,531.2           | 39,297.9           | 32,625.0           |
| <b>Operating Profit</b>                   | <b>32,300.4</b>                            | <b>29,196.3</b>    | <b>38,063.4</b>    | <b>66,801.2</b>    | <b>46,024.9</b>    |
| Other Non-operating Items (Net)           | (5,139.5)                                  | (1,454.4)          | (19.9)             | (2,629.9)          | 81.0               |
| Tax                                       | 14,116.0                                   | 6,350.6            | 5,280.3            | 11,152.3           | 9,304.1            |
| Net Income                                | 13,045.0                                   | 21,391.2           | 32,763.3           | 53,018.9           | 36,801.8           |
| Other Comprehensive Income                | 5,809.5                                    | 1,728.4            | 2,375.3            | (2,814.3)          | 6,316.0            |
| <b>Fitch Comprehensive Income</b>         | <b>18,854.5</b>                            | <b>23,119.7</b>    | <b>35,138.6</b>    | <b>50,204.6</b>    | <b>43,117.8</b>    |
| <b>Summary Balance Sheet</b>              |  |                    |                    |                    |                    |
| Gross Loans                               | 4,383,129.7                                | 4,521,146.5        | 4,493,106.2        | 4,115,607.3        | 3,701,502.1        |
| Impaired Loans Included Above             | 145,692.9                                  | 148,032.7          | 107,954.1          | 88,202.7           | 85,990.3           |
| Loan Loss Allowances                      | 134,961.7                                  | 141,631.0          | 140,168.4          | 85,464.9           | 62,968.9           |
| Net Loans                                 | 4,248,167.9                                | 4,379,515.6        | 4,352,937.8        | 4,030,142.4        | 3,638,533.3        |
| Interbank                                 | 221,322.8                                  | 77,790.3           | 338,147.2          | 185,619.9          | 123,709.0          |
| Derivatives                               | 10,777.3                                   | 678.8              | 6,321.9            | 5,893.2            | 13,026.1           |
| Other Securities & Earning Assets         | 1,281,602.3                                | 1,222,764.8        | 1,141,315.7        | 996,959.1          | 1,178,806.4        |
| Total Earning Assets                      | 5,761,870.4                                | 5,680,749.6        | 5,838,722.6        | 5,218,614.5        | 4,954,074.7        |
| Cash and Due from Banks                   | 877,937.4                                  | 947,675.1          | 944,623.1          | 752,190.3          | 726,558.9          |
| Other Assets                              | 366,051.2                                  | 365,499.9          | 292,381.4          | 273,898.8          | 260,353.7          |
| <b>Total Assets</b>                       | <b>7,005,858.9</b>                         | <b>6,993,924.6</b> | <b>7,075,727.1</b> | <b>6,244,703.6</b> | <b>5,940,987.3</b> |
| <b>Liabilities</b>                        |  |                    |                    |                    |                    |
| Customer deposits                         | 5,052,123.0                                | 4,730,470.8        | 4,795,417.4        | 4,141,554.1        | 3,911,738.2        |
| Interbank and Other Short-Term funding    | 348,718.2                                  | 598,391.3          | 372,363.1          | 321,830.6          | 553,397.2          |
| Other Long-Term funding                   | 695,070.1                                  | 802,912.2          | 1,041,511.4        | 992,697.4          | 756,795.2          |
| Trading Liabilities and Derivatives       | 2,320.4                                    | 9,514.2            | 7,775.9            | 9,197.6            | 0.0                |
| <b>Total Funding</b>                      | <b>6,098,231.8</b>                         | <b>6,141,288.4</b> | <b>6,217,067.7</b> | <b>5,465,279.6</b> | <b>5,221,930.6</b> |
| Other Liabilities                         | 235,015.4                                  | 205,281.0          | 234,424.0          | 190,327.1          | 180,164.4          |
| Pref. Shares and Hybrid Capital           | N.A.                                       | N.A.               | N.A.               | N.A.               | N.A.               |
| <b>Total Equity</b>                       | <b>672,611.8</b>                           | <b>647,355.1</b>   | <b>624,235.5</b>   | <b>589,096.8</b>   | <b>538,892.3</b>   |
| <b>Total Liabilities and Equity</b>       | <b>7,005,858.9</b>                         | <b>6,993,924.6</b> | <b>7,075,727.1</b> | <b>6,244,703.6</b> | <b>5,940,987.3</b> |
| <b>Ratios (Annualized as Appropriate)</b> |  |                    |                    |                    |                    |
| <b>Profitability</b>                      |  |                    |                    |                    |                    |
| Operating Profit/RWA                      | 1.6  | 0.7                | 0.9                | 1.7                | 1.2                |
| NII/Average Earning Assets                | 4.1  | 4.5                | 4.2                | 4.9                | 4.6                |
| Non-interest Expense/Gross Revenues       | 62.5                                       | 64.6               | 65.1               | 65.6               | 72.6               |
| Net Income/Average Equity                 | 4.0  | 3.4                | 5.4                | 9.4                | 7.1                |
| <b>Asset Quality</b>                      |  |                    |                    |                    |                    |
| Impaired Loans Ratio                      | 3.3  | 3.3                | 2.4                | 2.1                | 2.3                |
| Growth in Gross Loans                     | (3.1)                                      | 0.6                | 9.2                | 11.2               | 11.1               |

## Summary Financials and Key Ratios (Continued)

| (CRC Mil., Years Ended Dec. 31)             | 6/30/19<br>Six Mos. — Interim<br>Unaudited | 2018<br>Audited | 2017<br>Audited | 2016<br>Audited | 2015<br>Audited |
|---|--|-----------------|-----------------|-----------------|-----------------|
| Loan Loss Allowances/Impaired Loans         | 92.6                                       | 95.7            | 129.8           | 96.9            | 73.2            |
| Loan Impairment Charges/Average Gross Loans | 1.4  | 2.0             | 1.7             | 1.0             | 0.9             |
| <b>Capitalization</b>                       |  |                 |                 |                 |                 |
| Fitch Core Capital Ratio                    | 12.5                                       | 11.5            | 12.3            | 12.6            | 12.3            |
| TCE Ratio                                   | 8.5  | 8.1             | 8.4             | 9.1             | 8.6             |
| CET 1 Ratio                                 | N.A.                                       | N.A.            | N.A.            | N.A.            | N.A.            |
| Basel Leverage Ratio                        | N.A.                                       | N.A.            | N.A.            | N.A.            | N.A.            |
| Net Impaired Loans/FCC                      | 2.1  | 1.3             | (6.0            | 0.5             | 5.0             |
| <b>Funding &amp; Liquidity</b>              |  |                 |                 |                 |                 |
| Loans/Customer Deposits                     | 86.8                                       | 95.6            | 93.7            | 99.4            | 94.6            |
| LCR   | N.A.                                       | N.A.            | N.A.            | N.A.            | N.A.            |
| Customer Deposits/Funding                   | 82.9                                       | 77.2            | 77.2            | 75.9            | 74.9            |
| NSFR  | N.A.                                       | N.A.            | N.A.            | N.A.            | N.A.            |

N.A. – Not applicable.

Source: Fitch Ratings, BNCR.

## Key Financial Metrics – Latest Developments

### Challenges Prevail in a Difficult Environment

On Oct. 30, 2019, Fitch affirmed Costa Rica's Long-Term, Foreign-Currency IDR at 'B+'. The Rating Outlook is Negative. This action reflects weaknesses in public finances and political gridlock that has prevented timely passage of reforms. The new fiscal rule is untested, and the requirement of congressional authorization of foreign borrowings periodically constrains Costa Rica's financing flexibility. This is counterbalanced by strong governance, and higher economic development and per-capita income.

The Negative Rating Outlook reflects downside risks related to high fiscal deficits and a steep amortization schedule, against a background of economic slowdown. A rapidly climbing interest bill will keep the fiscal deficit higher than peers' and the debt burden on a relatively steep upward trajectory. In July 2019, Costa Rica's legislative assembly approved an external bond issuance of USD1.5 billion (equivalent to 2.5% of GDP) for this year, which reduces slightly the uncertainty regarding Costa Rica's ability to meet this year's financing needs.

According to Fitch's criteria, the operating environment assessment is the result of the combination of two core metrics: GDP per capita and the World Bank's Ease of Doing Business ranking. Fitch believes these ratios have the greatest explanatory power in determining the ability of banks to generate business volumes with acceptable levels of risk.

### Reasonable Asset Quality

Fitch believes BNCR's loans quality is reasonable. The NPL ratio presented an increasing trend from 2016 to 2018, stabilizing at 3.3% at 1H19, as a reflection of the actions taken by the institution to control asset quality deterioration, although this compares negatively with the industry (average 2015-1H19: 2.1%). This performance is the result of a difficult economic environment and a deterioration of some sectors, such as mortgage residential, consumer, services and commerce. Fitch expects the delinquency metric to remain similar to the 1H19 level.

In 2018 (1.9%) and 1H19 (1.4%), the net chargeoffs to gross loans ratio was higher than the average of previous years (2015-2017: 0.15%). The loan book is diversified, and the debtor's concentration is considered as moderate by Fitch, since as of June 2019, the 20 main debtors accounted for 11.0% of gross loans and 0.9x FCC. BNCR had gradually improved its reserve coverage ratio, from 73.2% in 2015 to 129.8% in 2017; however, in 2018 and 1H19, the ratio declined on average to 94.2%, which was below the industry level. Fitch believes that, given the proportion of mortgage loans, there is ample collateral arising from this portfolio.

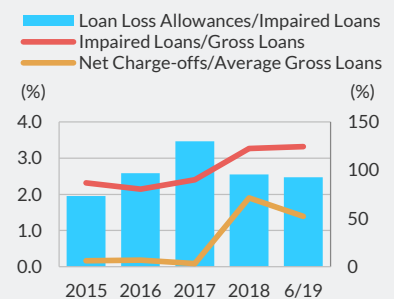
As of 1H19, the majority of the securities portfolio was composed of government instruments, representing around 72.5%. The portfolio also accounted for 17.4% of the assets and 24.1% of the deposits.

### Profitability with Positive Trend

As of 1H19, the bank's profitability improved, following a downward trend in the past several years. The operating profit to RWA ratio was 1.6% at June 2019, up from 0.7% in 2018 (2016: 1.7%); however, the level compares unfavorably with that of some peers. Performance was influenced mainly by higher loan impairment charges and offset by better operating efficiency. Fitch expects this evolution to continue in the medium term as a result of diverse initiatives, although it might not be so relevant given the effect of the new regulation and a longer economic recovery.

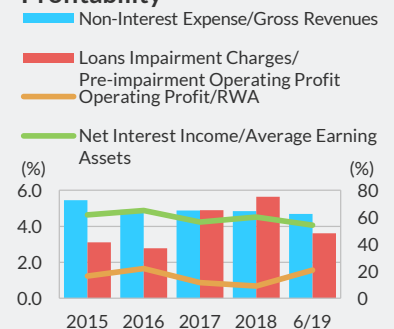
The ratio of loan impairment charges to pre-impairment operating profit increased from 2016 to 2018 (37.0% to 75.2%), but at 1H19, it declined to 48.2%. On the other hand, the efficiency ratio fell to 62.5% at 1H19 from 72.6% in 2015. This behavior was reflected in better profitability. The ROAA showed a declining trajectory and, at 1H19, reached 0.9%, similar to the industry level. The net interest margin (NIM) fluctuated around 4.5% during the past four years and, at the end of 1H19, was 4.1%. This metric compares negatively with the system average of 5.4% for 2015-1H19.

### Asset Quality



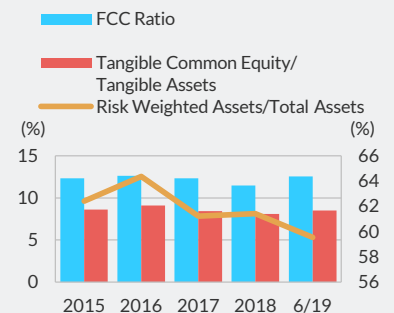
Source: Fitch Ratings, BNCR.

### Profitability



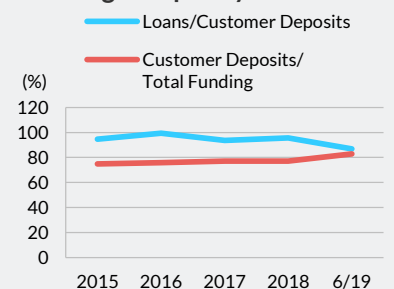
Source: Fitch Ratings, BNCR.

### Capitalization



Source: Fitch, Ratings, BNCR.

### Funding & Liquidity



Source: Fitch Ratings, BNCR.



### Appropriate Capitalization

Fitch considers the bank's capitalization as adequate. During the last several years, the capital levels have exhibited stability; the FCC to RWA metric averaged 12.4% from 2015 to 2017 but, in 2018, declined to 11.5%, and, at 1H19, bucked the trend to reach 12.5%, which was driven by the measures taken by the entity to continue strengthening its equity position, combined with a small reduction in the RWA due to the contraction of the loan portfolio. The tangible equity to tangible assets ratio remained stable in the same period (average 8.5%), but compares negatively with the system average (11.5%).

As of June 2019, the regulatory ratio was 13.3%, above the minimum requirement of 10%. Fitch believes this provides the bank flexibility to absorb possible losses in a crisis scenario. Also, we expect the entity to continue strengthening its capitalization, supported by lower growth, despite the challenging environment.

### Robust Funding Structure

In Fitch's view, BNCR's funding structure is solid, sustained by its strong franchise and sovereign support. The bank has an ample and stable deposit base, in addition to the largest market share in customer deposits. As of June 2019, these accounted for 82.9% of total funding. Also, the entity has relationships with diverse national and global institutions, which allow it to have additional financing alternatives; it has issued debt in both local and international markets, and it has subordinated debt.

As of June 2019, customer deposits exhibited growth, while loans decreased, which resulted in a loans to deposits ratio of 86.8%, below the average from 2015 to 2018 of 95.8% and the industry metric (average 2015-1H19: 104.2%). Regarding depositor concentration, Fitch considers this as moderate since the 20 largest depositors represented 17.3% of total customer deposits at 1H19.

BNCR's liquidity profile is good. As of 1H19, the bank presented negative gaps between assets and liabilities in the majority of the periods; however, Fitch believes that this does not constrain the bank's liquidity, given that this is mitigated by the historical stability of deposits and its leading role in the system.

BNCR also maintains available credit lines from international banks. Likewise, assets such as cash and equivalents, and trading and available-for-sale securities accounted for 33.1% of total assets and 45.8% of customer deposits at the end of June 2019. At this date, the bank's liquidity coverage ratio (under Sugef regulation) in both currencies was above 100% (colones (CRC):198.03%; USD: 302.94%).



## Environmental, Social and Governance Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of 3. ESG issues are credit neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity.

BNCR has ESG Relevance Scores of '4' for Governance Structure Issue driven by its state ownership that could potentially influence the business model and financial performance of the bank due to the government's plans and incentives.

## FitchRatings Banco Nacional de Costa Rica

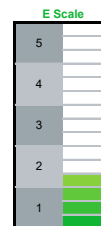
## **Banks** Ratings Navigator

### Credit-Relevant ESG Derivation

|  |                     |   |        | Overall ESG Scale |  |
|--|---------------------|---|--------|-------------------|--|
| Banco Nacional de Costa Rica has 1 ESG rating driver and 4 ESG potential rating drivers  |                     |   |        |                   |  |
| ➤ Banco Nacional de Costa Rica has exposure to board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions which, in combination with other factors, impacts the rating. | key driver          | 0 | issues | 5                 |  |
| ➤ Banco Nacional de Costa Rica has exposure to compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security) but this has very low impact on the rating.  | driver              | 1 | issues | 4                 |  |
| ➤ Banco Nacional de Costa Rica has exposure to operational implementation of strategy but this has very low impact on the rating.  | potential driver    | 4 | issues | 3                 |  |
| ➤ Banco Nacional de Costa Rica has exposure to organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership but this has very low impact on the rating.  | not a rating driver | 4 | issues | 2                 |  |
| ➤ Banco Nacional de Costa Rica has exposure to quality and frequency of financial reporting and auditing processes but this has very low impact on the rating.   |                     | 5 | issues | 1                 |  |

### Environmental (E)

| General Issues   | E Score | Sector-Specific Issues   | Reference  |
|--|---------|--|--|
| GHG Emissions & Air Quality                                | 1       | n.a.   | n.a.   |
| Energy Management  | 1       | n.a.   | n.a.   |
| Water & Wastewater Management                              | 1       | n.a.   | n.a.   |
| Waste & Hazardous Materials Management; Ecological Impacts | 1       | n.a.   | n.a.   |
| Exposure to Environmental Impacts                          | 2       | Impact of extreme weather events on assets and/or operations and corresponding risk appetite & management; catastrophe risk; credit concentrations | Company Profile; Management & Strategy; Risk Appetite; Asset Quality |



#### How to Read This Page

ESG scores range from 1 to 5 based on a 15-level color gradation. Red (5) is most relevant and green (1) is least relevant.

The Environmental (E), Social (S) and Governance (G) tables break out the individual components of the scale. The left-hand box shows the aggregate E, S, or G score. General Issues are relevant across all markets with Sector-Specific Issues unique to a particular industry group. Scores are assigned to each sector-specific issue. These scores signify the credit-relevance of the sector-specific issues to the issuing entity's overall credit rating. The Reference box highlights the factor(s) within which the corresponding ESG issues are captured in Fitch's credit analysis.

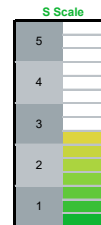
The Credit-Relevant ESG Derivation table shows the overall ESG score. This score signifies the credit relevance of combined E, S and G issues to the entity's credit rating. The three columns to the left of the overall ESG score summarize the issuing entity's sub-component ESG scores. The box on the far left identifies the [number of] general ESG issues that are drivers or potential drivers of the issuing entity's credit rating (corresponding with scores of 3, 4 or 5) and provides a brief explanation for the score.

Classification of ESG issues has been developed from Fitch's sector and sub-sector ratings criteria and the General Issues and the Sector-Specific Issues have been informed with SASB's Materiality Map.

Sector references in the scale definitions below refer to Sector as displayed in the Sector Details box on page 1 of the navigator.

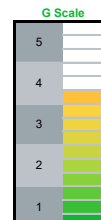
### Social (S)

| General Issues   | S Score | Sector-Specific Issues   | Reference  |
|--|---------|--|--|
| Human Rights, Community Relations, Access & Affordability  | 2       | Services for underbanked and underserved communities: SME and community development programs; financial literacy programs                                  | Company Profile; Management & Strategy; Risk Appetite                        |
| Customer Welfare - Fair Messaging, Privacy & Data Security | 3       | Compliance risks including fair lending practices, mis-selling, repossession/foreclosure practices, consumer data protection (data security)               | Operating Environment; Company Profile; Management & Strategy; Risk Appetite |
| Labor Relations & Practices                                | 2       | Impact of labor negotiations, including board/employee compensation and composition  | Company Profile; Management & Strategy                                       |
| Employee Wellbeing   | 1       | n.a.   | n.a.   |
| Exposure to Social Impacts                                 | 2       | Shift in social or consumer preferences as a result of an institution's social positions, or social and/or political disapproval of core banking practices | Company Profile; Financial Profile   |



### Governance (G)

| General Issues         | G Score | Sector-Specific Issues  | Reference  |
|------------------------|---------|---|--|
| Management Strategy    | 3       | Operational implementation of strategy  | Management & Strategy  |
| Governance Structure   | 4       | Board independence and effectiveness; ownership concentration; protection of creditor/stakeholder rights; legal /compliance risks; business continuity; key person risk; related party transactions | Management & Strategy; Earnings & Profitability; Capitalisation & Leverage |
| Group Structure        | 3       | Organizational structure; appropriateness relative to business model; opacity; intra-group dynamics; ownership  | Company Profile  |
| Financial Transparency | 3       | Quality and frequency of financial reporting and auditing processes   | Management & Strategy  |



### CREDIT-RELEVANT ESG SCALE

#### How relevant are E, S and G issues to the overall credit rating?

|   |   |
|---|---|
| 5 | Highly relevant, a key rating driver that has a significant impact on the rating on an individual basis. Equivalent to "higher" relative importance within Navigator.                         |
| 4 | Relevant to rating, not a key rating driver but has an impact on the rating in combination with other factors. Equivalent to "moderate" relative importance within Navigator.                 |
| 3 | Minimally relevant to rating, either very low impact or actively managed in a way that results in no impact on the entity rating. Equivalent to "lower" relative importance within Navigator. |
| 2 | Irrelevant to the entity rating but relevant to the sector.   |
| 1 | Irrelevant to the entity rating and irrelevant to the sector.   |

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