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Rating Action: Moody's affirms Banco de la Nación and Scotiabank Peru's ratings with a negative outlook; Cofide affirmed with stable outlook

25 May 2021

New York, May 25, 2021 -- Moody's Investors Service ("Moody's") has today affirmed the supported ratings and assessments of Banco de la Nación, Scotiabank Perú S.A.A. (Scotiabank) and Corporación Financiera de Desarrollo S.A. (Cofide).

Moody's affirmed Banco de la Nación's A3 and Prime-2 long- and short-term global scale local and foreign currency deposit ratings, the baa2 baseline credit assessment (BCA) and baa2 adjusted BCA. Banco de la Nación's A3 and Prime-2 long- and short-term counterparty risk ratings (CRRs) and its A3(cr) and Prime-2(cr) long- and short-term counterparty risk assessments (CRAs) were also affirmed.

Moody's affirmed Scotiabank's A3 and Prime-2 long- and short-term global scale local and foreign currency deposit ratings, its Baa2 subordinated debt rating, and the baa1 adjusted baseline credit assessment (BCA). Scotiabank's A3 and Prime-2 long- and short-term counterparty risk ratings (CRRs) and its A3(cr) and Prime-2(cr) long- and short-term counterparty risk assessments (CRAs) were also affirmed. Scotiabank's BCA was upgraded to baa2 from baa3.

Moody's affirmed Cofide's Baa3 long-term global scale local and foreign currency issuer ratings, the b2 baseline credit assessment (BCA) and b2 adjusted BCA. Cofide's Baa2 and Prime-2 long- and short-term counterparty risk ratings (CRRs) and its Baa2(cr) and Prime-2(cr) long- and short-term counterparty risk assessments (CRAs) were also affirmed.

The outlook on Banco de la Nación's and Scotiabank's ratings has been changed to negative from stable, in line with the outlook of the ratings of the Peruvian government. The outlook on Cofide's ratings remains stable.

A complete list of affected ratings can be found at the end of this press release.

RATINGS RATIONALE

The rating actions on Banco de la Nación, Scotiabank and Cofide follow the affirmation with a negative outlook on the sovereign bond ratings.

The outlook change to negative from stable on the Peruvian sovereign's A3 ratings reflects Moody's view that an increasingly polarized and fractured political environment has been undermining the effectiveness of the country's policymaking, leading to a progressive deterioration in Peru's institutional strength. The affirmation of the Peruvian government's A3 rating reflects Moody's view of the relative resilience of the Peruvian economy and the strength of the government's balance sheet even after consideration is made of the effects of the pandemic. See the sovereign press release for more details: https://www.moody.com/research/--PR_445868.

AFFIRMATION OF BANCO DE LA NACIÓN'S RATINGS WITH A NEGATIVE OUTLOOK

The affirmation of Banco de la Nación's ratings with a negative outlook is in line with Moody's assessment of the bank as government-backed by the Peruvian national government (A3 negative) because of its ownership by the Peruvian Ministry of Economy and Finance and role as the financial agent for Peruvian national, regional and local administrations, and government-owned enterprises. Banco de la Nación's ratings benefit from a two-notch uplift from its standalone BCA of baa2.

Moody's also affirmed Banco de la Nación's baa2 BCA in line with low assets risks, strong profitability, high holdings of liquid assets, and ample capitalization. The bank's funding mix benefits from its preferential access to a large base of inexpensive, though highly concentrated, judicial and administrative deposits related to the government. The bank's strengths are partially offset by its limited business diversification, given its narrow focus on serving government employees and entities, and the fact that its performance is tied to the policies of the national government.

Banco de la Nación's nonperforming loan (NPL) ratio remains low, at 2.1% as of March 2021, up only slightly

from 1.8% as December 2019 prior to the pandemic, because of its focus on lower risk lending tightly tied to lending to government employees and entities. As the bank faced difficulties in originating payroll-linked loans because of Peru's strict lockdowns during 2020, the bank complemented its loan growth with an extraordinary PEN1.7 billion loan to its fellow government-owned development bank Cofide (Baa3 stable), which represents 23% of loans as of March 2021.

Banco de la Nación's high profitability benefits from an ample net interest margin, low credit costs, and recurring fee income that balance the higher operating costs related to its nationwide presence. Nevertheless, during Q1 2021 net income to tangible assets fell to 0.84%, from 3.38% a year ago in line with lower interest rates and a higher exposure to lower yielding assets, such as loans to government entities, where the bank directed excess liquidity stemming from an increase in government deposits. In fact, the bank's loan-to-deposits ratio fell to 19% as of March 2021, from 22% last year, while its holdings of liquid assets remain strong, at 80.0% of tangible banking assets.

Measured by tangible common equity to risk-weighted assets, Banco de la Nación's capitalization is among the highest for Moody's rated banks in Peru at 14.8% as of March 2021, even after falling about 80 basis points since 2019 related to its asset expansion. While the bank's profitability is high, it provides limited benefit to its capital ratio, because annual earnings must be transferred to the Public Treasury and destined for sovereign bond repayment, according to the bank's bylaws and Supreme Decree, SD 002-2007.

The outlook change to negative, from stable, incorporates the outlook change on the A3 sovereign ratings of the Government of Peru, in line with Moody's expectation that the capacity of the Peruvian government to provide Banco de la Nación with financial support may fall because of increased political risks that could result from the erosion of the economic institutions that have enabled high GDP growth.

AFFIRMATION OF SCOTIABANK'S RATINGS WITH NEGATIVE OUTLOOK; UPGRADE OF BCA

The upgrade of the Scotiabank's BCA reflects its improved capitalization ratios as well as the strength of the bank's business model in Peru as evidenced by its strong deposit-based funding profile, significant holdings of liquid assets and historically high profitability ratios. The bank's higher BCA, though, continues to consider the challenges to Scotiabank's asset risk related to its higher than average exposure to riskier small and midsize enterprise (SME) and consumer financing offset by a high reserve coverage.

Scotiabank's A3 deposit ratings capture Moody's assessment of the high probability that its parent bank, Bank of Nova Scotia (BNS, Aa2 stable), will provide financial support to the Peruvian subsidiary in the event of stress, reflecting Scotiabank's strategic importance to BNS. The incorporation of affiliate support lifts the baa2 BCA by one notch to an adjusted BCA of baa1. In addition, the ratings incorporate Moody's assumption of a moderate probability of government support in case of stress, which derives from Scotiabank's systemic importance as the third largest bank in the system and sizable deposit market share of 14% as of December 2020, generating one notch of uplift from its adjusted BCA of baa1 to an A3 deposit rating.

The negative outlook on the ratings reflects the negative outlook on the sovereign bond rating.

Scotiabank is a key part of BNS's operations in Pacific Alliance countries, operating a universal banking business model. As of March 2021, its lending operations in 2020 were split 30% to corporates, 37% to SMEs and 17% to consumers, and 16% to mortgages. Scotiabank's capitalization ratio was 15.3% as calculated by Moody's adjusted capitalization ratio of tangible common equity relative to risk weighted assets (TCE/RWA), in 2020 which compares favorably to peers. Historically the bank's capitalization has been supported by its strong profitability, as shown by its average ratio of net income to tangible assets of 2.03% between 2016-2019. However, in 2020 profitability fell to 0.3% driven by an 83% increase in provisioning expenses as a result of asset quality pressures during the pandemic and given its exposures to relatively riskier SMEs and credit card borrowers. As a result, the bank's NPL ratio rose to 4.7% in 2020 from 3.0% in 2019. Moody's notes that reserves coverage of over 200% and strong capitalization levels provide the bank a solid buffer against asset risks. In addition, the rating agency expects Scotiabank's profitability to post a strong recovery as Peru's economic recovery takes hold and the bank's track record in generating strong fee income from credit cards, foreign exchange operations, and wealth management.

Scotiabank benefits from a large and growing base of granular, retail, and low-cost deposits which account for the lion's share of its funding. As a result the bank has a low reliance on confidence sensitive funding with market funds to tangible banking assets at 22.9%. This is in turn buttressed by Scotiabank's holding of liquid assets that accounted for 33.4% of its tangible banking assets.

AFFIRMATION OF COFIDE'S RATINGS WITH A STABLE OUTLOOK

The affirmation of Cofide's Baa3 issuer ratings with a stable outlook incorporates Moody's assessment of a very high probability of government support, which translates into five notches of support from the bank's b2 BCA. The affirmation of Cofide's b2 BCA in turn incorporates the limited deterioration in the development bank's asset quality despite the pandemic as a result of improved risk management practices since 2018 and the rating agency's assessment of a higher loss absorption in its evaluation of the bank's capitalization. A key constraint on Cofide's ratings remains its still-high holdings of shares of Corporación Andina de Fomento (CAF, Aa3 stable) for the Peruvian government, limited profitability, and a funding mix consisting solely of market funding.

Moody's assessment of very high government support is in line with the development bank's increased importance in the execution of the Peruvian government's social and economic development programs during the coronavirus pandemic. During 2020, Cofide took on a critical role by providing financing through Reactiva Perú and various programs aimed at micro, small and midsize enterprises (MSMEs) in specific industries, all of which resulted in a 16% loan expansion year-over-year to PEN6 billion as of March 2021. Proposals by both candidates to Peru's presidency call for the enhancement of Cofide's role in the financing, promotion or formalization of MSMEs.

Cofide's NPL ratio has fallen significantly during the last few years as a result of a tighter underwriting standards since 2018, including lower single borrower exposures and a loan portfolio cleanup. Moody's expects Cofide's NPL ratio to remain high, in line with the 10.9% reported as of March 2021, indicative of the higher risks associated with long-term project finance, as well as the effects from the pandemic and an expanded participation in development programs. The 300-basis point deterioration in Cofide's NPL ratio was driven by a single loan of PEN207 million related to power generator and distributor Termochilca S.A., which underscores the risks related to Cofide's remaining high single borrower exposures.

Cofide's financial strength will benefit from the Peruvian government's willingness to enhance the loss-absorption capacity of the development bank's capitalization, as exhibited by the government's commitment to acquiring 14% of Cofide's CAF shares, a full earnings retention policy approved in January 2020 for 2019-21, and a commitment by the bank to retain high loan loss reserves. CAF shares are non-tradable and deeply illiquid holdings that Cofide holds for the Peruvian government. However, these shares also present low risks and an important asset for the Peruvian government. Although the government's payments for Cofide's CAF shares will be executed over four years, Moody's believes it signals the government's willingness to provide support and alleviate the bank of such a large exposure. Also, the bank's loss absorption is enhanced by its commitment to maintaining high loan loss reserves equivalent to 1.8x to 2.2x its NPLs. Moody's preferred capitalization ratio of tangible common equity to risk-weighted asset remains high at 17.3%, after falling 140 basis points because of high loan growth during 2020.

Cofide's net income to tangible asset of 0.83% is lower than those of its domestic bank peers because of a narrow net interest margin that stems from the lower interest rates it charges and its higher funding costs. Nevertheless, Cofide complements its profitability with fee income related to the origination of loans that has on average accounted for about half of its net interest income but increased to almost 80% of revenues during the pandemic. High fluctuations in credit costs related to Cofide's still high single-borrower exposures will continue to absorb a high percentage of earnings from time to time.

Cofide has a high reliance on market funds, at 71% of tangible banking assets as of March 2021, slightly above the level reported in previous years. Nevertheless, market funds are largely debt issuances in international markets and bank borrowings, offering a certain level of diversification. Liquidity falls to 40%, from 58.2% when excluding CAF shares.

The outlook remains stable in line with the Peruvian government's strong capacity to support Cofide in a moment of stress. Even if the government's bond rating were to fall to Baa1, in line with the negative outlook, Cofide's ratings would not be affected, given Moody's assessment of a very high willingness to provide support, evidenced by the bank's enhanced developmental role.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

BANCO DE LA NACIÓN

Given the negative outlook, an upgrade of Banco de la Nación's A3 deposit ratings is less likely. While less volatile profitability, a more granular deposit base, and a stabilization of capital metrics would have a positive impact on the bank's BCA, they would not affect its supported deposit ratings because they are already in line

with the government's A3 rating.

A downgrade of Peru's sovereign bond rating would exert downward pressure on the bank's ratings. A significant deterioration in the bank's capitalization or an increase in asset risks, or a sudden withdrawal of a substantial portion of its funding could exert downward pressure on its BCA, although this, all of in itself, would not likely affect the bank's deposit ratings because of government support.

SCOTIABANK

Following the upgrade of Scotiabank's BCA, there is little room for upward pressure. The bank's BCA though could face downward pressure if Scotiabank experiences a material deterioration of its asset quality or if its capitalization weakens significantly. Given the negative outlook, there is no room for upward pressure on Scotiabank's supported ratings. A downgrade of Peru's sovereign bond rating would lead to a downgrade on the bank's supported ratings.

COFIDE

Cofide's issuer ratings could face upward pressure with improvements in its asset-risk profile that would allow for its NPL ratio to fall substantially to 3%. Upward rating pressure could also emerge if there is a new capitalization or if the government were to commit to a higher acquisition of Cofide's CAF shares such that they no longer limit the bank's loss absorption in times of stress.

A significant deterioration in Cofide's asset risk, solvency or funding profile could lead to downward pressure on its Baa3 issuer ratings.

ISSUERS AND RATINGS AFFECTED

The following ratings and assessments of Banco de la Nación were affirmed:

- Long-term Global Scale Foreign and Local Currency Deposit Ratings of A3, outlook to negative from stable
- Short-term Global Scale Foreign and Local Currency Deposit Ratings of P-2
- Long- and Short-Term Counterparty Risk Assessments of A3(cr) and P-2(cr)
- Long- and Short-Term Global Scale Local and Foreign Currency Counterparty Risk Ratings of A3 and P-2
- Baseline credit assessment of baa2
- Adjusted baseline credit assessment of baa2
- Outlook changed to Negative from Stable

The following assessment of Scotiabank Perú S.A.A. was upgraded:

- Baseline credit assessment to baa2 from baa3

The following ratings and assessments of Scotiabank Perú S.A.A. were affirmed:

- Long-Term Global Scale Local and Foreign Currency Deposit Ratings of A3, outlook to negative from stable
- Short-term Global Scale Local and Foreign Currency Deposit Ratings of P-2
- Global Scale Foreign Currency Subordinated Debt Rating of Baa2
- Adjusted baseline credit assessment of baa1
- Long- and Short-Term Counterparty Risk Assessments of A3(cr) and P-2(cr)
- Long- and Short-Term Global Local and Foreign Currency Counterparty Risk Ratings A3 and P-2
- Outlook changed to Negative from Stable

The following ratings and assessments of Corporación Financiera de Desarrollo S.A. were affirmed:

- Long-Term Global Scale Local and Foreign Currency Issuer Ratings of Baa3, outlook remains stable

- Long- and Short-Term Counterparty Risk Assessments of Baa2(cr) and P-2(cr)
- Long- and Short-Term Global Scale Local and Foreign Currency Counterparty Risk Ratings of Baa2 and P-2
- Baseline credit assessment of b2
- Adjusted baseline credit assessment of b2
- Outlook remains stable

The principal methodology used in these ratings was Banks Methodology published in March 2021 and available at https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_1261354 . Alternatively, please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

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For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found at: https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBC_79004.

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