Banco Internacional de Costa Rica S.A. 'BB/B' Ratings Affirmed, Based On Revised Bank Criteria; Outlook Stays Stable

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Overview

- Following a review of BICSA under Standard & Poor's revised bank criteria (published on Nov. 9, 2011), we have affirmed our 'BB/B' issuer credit ratings on BICSA. The outlook remained stable.
- Our ratings on BICSA reflect its adequate business position, capital and earnings, and risk position, and average funding and adequate liquidity profiles.
- We expect that BICSA's will keep improving its financial performance through tighter operational controls, a more-disciplined approach to loan portfolio growth, and improvements in corporate governance.

Rating Action

As we previously announced, on Dec. 13, 2011, Standard & Poor's Ratings Services affirmed its 'BB/B' ratings on Panama-based Banco Internacional de Costa Rica S.A. The stand-alone credit profile (SACP) is 'bb'. The outlook remained stable.

Rationale

We base our ratings on BICSA on its "adequate" (as our criteria define it) business position, and its adequate risk-adjusted capital (RAC) ratio supported by its moderate earnings capacity. We also consider its "adequate" risk position, "average" funding structure, and "adequate" liquidity profile. We base the ratings on BICSA solely on its SACP, rather than on expected extraordinary support from the Costa Rican government. We consider BICSA as a government-related entity (GRE) in the **Republic of Costa Rica** (foreign currency: BB/Stable/B; local currency: BB+/Stable/B) because of a shareholding structure through which the country's two largest public banks wholly own it.

The 'bb' anchor draws on our Banking Industry Country Risk Assessment (BICRA) methodology and our view of the weighted average economic risk in the countries in which the bank has exposure through its loan book. A BICRA is scored on a scale from '1' to '10', ranging from the lowest risk banking systems (group '1') to the highest risk (group '10'). BICSA operates mainly Costa Rica, Panama, and other countries in Central America. As a result, its weighted economic risk is '6'. The common factor driving this economic risk score is low income levels in the countries where the bank operates, which affects the country's vulnerability to external shocks, and debt and payment capacity in countries with weak rule of law. The industry risk for Panama, where the bank is established, is '5'. The legal framework there generally still lags international standards because the method for calculating capital requirements doesn't account for all the risks that banks face, weighing instead more heavily on industry risk. Also, Panama lacks a lender of last resort. We classify Panama as "support uncertain" because the large banks in the country are difficult to support.

Our assessment of BICSA's "adequate" business position is based on the bank's strong and experienced management team, which has successfully handled the moderate diversification of the bank's activities. Even though we consider trade finance activities to have lower business stability than other banking operations, BICSA's revenues have remained somewhat impervious during the worldwide economic slowdown, and the geographic mix of its business has not shown material changes. The bank has significant exposure in Central America, with approximately 70% of its assets concentrated in this region as of June 30, 2011. On the other hand, management has taken steps to diversify its investment portfolio in countries with higher ratings. Although the bank's exposure to nations with long-term sovereign ratings below 'BBB-' has decreased following a more conservative strategy and approach to risk, overall exposure to 'BB' rated economies still remains at about 50%, and the more-adverse economic conditions in these countries remain a challenge. A more diversified portfolio is a must for higher ratings, but we don't expect that BICSA's loan portfolio will diversify significantly, based on the bank's background and business lines.

Our assessment of BICSA's "adequate" capital and earnings results from the bank's adequate RAC ratio and moderate earnings capacity. Our projection of the bank's RAC ratio for 2011 is 9%, a level that compares well with immediate peers'. Even with expected growth in 2011 and 2012, we expect RAC to remain at 9% to 10%. The bank will leverage its growth in Panama rather than in the rest of the countries in its business mix, but we expect its main concentration to remain in Costa Rica. Because expected growth in Central American economies with higher risk charges will be marginal, we don't expect major pressures on the current RAC. BICSA's earnings ratios are close to its main peers' average. Trading gains and other market-sensitive revenues don't represent a material weight in its revenue mix, in our view.

Our risk position assessment for BICSA is "adequate," based on the bank's conservative underwriting standards over the past few years, even though the bank's loan concentration exposes it to significant spikes in its asset quality. Based on the portfolio's geographic mix, we believe the bank needs to focus on maintaining asset quality, but the short-term nature of its loan portfolio also gives it more flexibility than other banks to adapt to changing market conditions. BICSA doesn't offer complex products.

We deem BICSA's funding "average" and its liquidity "adequate." We expect a loan-to-deposit ratio of about 120% in the next two years, a more aggressive level than at other banks in the Panamanian banking system. Core customer deposits continue to be the main funding source, accounting for 62% of the total funding base as of June 2011. Total market debt in proportion to total liabilities, at 16% as of June 2011, is higher than at other banks in the country. However, we believe the bank would have access to market debt if it needed it, and refinancing risk is somewhat limited, considering that it faces no significant maturities in the short term and maintains good financial performance.

According to our methodology for GREs, we consider BICSA to be an institution with a limited important role for, and a limited link to, the government of Costa Rica. In our opinion, there is a low probability that the government would support the bank in a period of stress. Therefore, we don't incorporate any notches of uplift to the SACP.

Outlook

Our stable outlook on BICSA reflects our expectation that the bank will maintain "adequate" capital based on its conservative earning retention policy and sound underwriting practices. We could lower the ratings if its RAC falls below 7% or if economic conditions in the countries in which it operates hurt its loan portfolio's profitability. We could also raise the ratings on the bank if we raise the sovereign ratings on Costa Rica.

Ratings Score Snapshot

Issuer Credit Rating	BB/Stable/B

SACP	bb
Anchor	bb
Business Position	Adequate (0)
Capital and Earnings	Adequate (0)
Risk Position	Adequate (0)
Funding and Liquidity	Average and Adequate (0)
Support	0
GRE Support	0
Group Support	0
Sovereign Support	0
Additional Factors	0

Related Criteria And Research

- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- **DisplayText cannot span more than one line!**, Nov. 9, 2011
- **DisplayText cannot span more than one line!**, Aug. 25, 2011

Ratings List

Ratings Affirmed

Banco Internacional de Costa Rica S.A.

Counterparty Credit Rating	BB/Stable/B
Certificate Of Deposit	
Foreign Currency	BB/B