

## Banco del Estado de Chile

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### Table Of Contents

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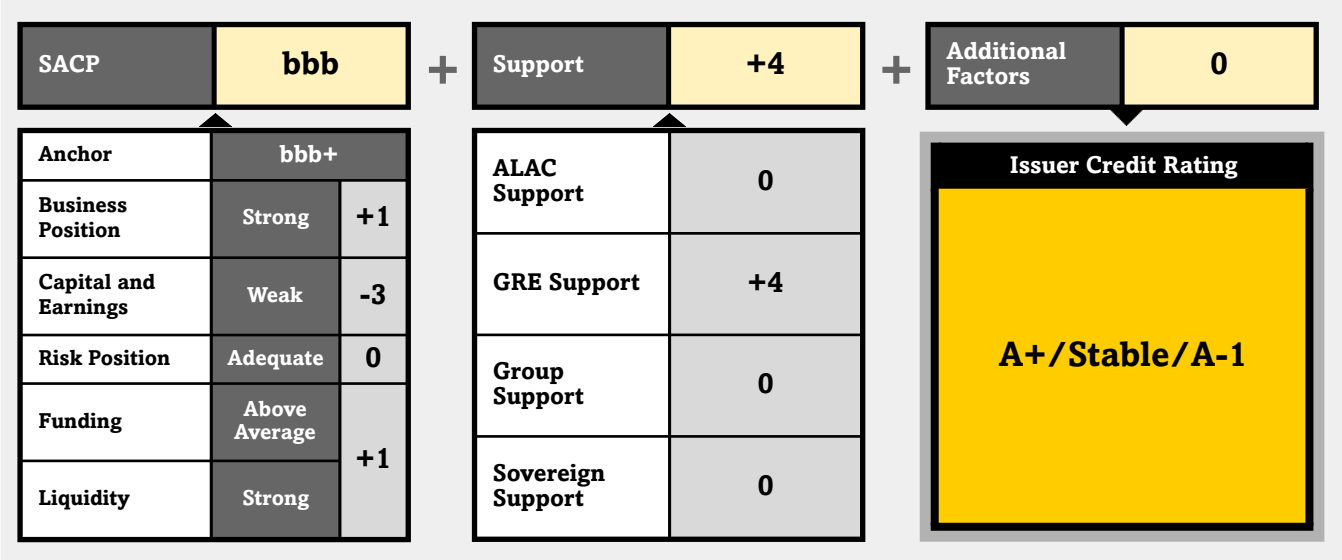
Major Rating Factors

Outlook

Rationale

Related Criteria

# Banco del Estado de Chile



## Major Rating Factors

Strengths:	Weaknesses:
<ul style="list-style-type: none"> <li>Extremely high likelihood of extraordinary support from the Chilean government;</li> <li>Strong business position as the third-largest bank in terms of loans in Chile; and</li> <li>Above-average and diversified funding, given its access to a large and stable deposit base.</li> </ul>	<ul style="list-style-type: none"> <li>Weak capital position based on our risk-adjusted capital (RAC) framework; and</li> <li>Although improving, weaker-than-average profitability (including the effect of a higher tax burden compared to peers).</li> </ul>

## Outlook: Stable

The stable outlook on Banco del Estado de Chile (Banco Estado) for the next 24 months reflects that on the sovereign, and our expectation that the bank will maintain its strong market position and public policy role. Given that we expect an extremely high likelihood of government support, our ratings on Banco Estado will move in tandem with those on the sovereign, as long as the bank maintains its stand-alone credit profile (SACP) at 'bb-' or above (the SACP is currently 'bbb').

### Downside scenario

We could lower the ratings on the bank in the next 24 months if we downgrade the sovereign.

### Upside scenario

We could raise the ratings on Banco Estado in the next 24 months if we take a similar action on the sovereign.

## Rationale

The ratings on Banco Estado reflect its strong business position as the country's only state-owned bank, and its business scale and stability stemming from its status as the country's third-largest bank in terms of total loans and the largest in terms of deposits. The weak capital and earnings profile is a credit shortcoming for the bank. In our capital assessment, we use our RAC ratio, which incorporates the effect of the deduction of deferred tax assets from the bank's capital. We consider Banco Estado to have an adequate risk profile with plain vanilla operations focused on lending, and asset quality metrics and business mix that fit with its public bank role and mandate of expanding banking services to the lower- and middle-income slices of the population. We consider Banco Estado to have an above-average funding profile thanks to a high share of stable deposits and strong liquidity.

The credit quality of the bank also incorporates our view that there's an extremely high likelihood that Chile (foreign currency: A+/Stable/A-1; local currency: AA-/Stable/A-1+) would provide extraordinary and timely support to the bank in the event of financial distress. Because of this support, the long-term issuer credit rating on the bank is four notches higher than its SACP, which is currently 'bbb'.

According to our criteria for government-related entities (GREs), we base our view of this support on our assessment of Banco Estado's very important role as a vehicle in promoting the low-income population's use of banking products and access to home ownership. We also account for the bank's integral link with the Chilean government, which fully owns the bank. Banco Estado and the government are integrally linked in terms of management, strategic and financial monitoring, coordination of debt issuance, and in fulfilling a public policy role. Because of these factors, we believe that there's an extremely high likelihood of support from Chile.

### **Anchor:'bbb+' for banks operating in Chile**

Our bank criteria use our Banking Industry Country Risk Assessment's (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. The anchor for banks operating only in Chile, where Banco Estado mainly operates, is 'bbb+', the strongest anchor in Latin America.

Chile's resilient economy reflects many years of sound and consistent economic policies, with a strong fiscal performance, low inflation, and a healthy financial system. However, the country's GDP per capita is still lower than those of more developed countries and its BICRA peers. Nonetheless, at about \$16,439 at the end of 2018, it's among the highest in the region and is gradually rising. Economic growth has picked up moderately in Chile in the context of general continuity in economic policies and higher copper prices (compared to 2016). We expect GDP to grow by about 3.3% in 2019 and 3.0% in 2020, compared to 4.0% in 2018. Additionally, we're seeing more moderate growth in credit and real estate prices than historical levels, which eases pressure on the sovereign's slightly weaker capacity to face external shocks and reduces the risks of cyclical credit-fueled asset bubbles. We expect the Chilean banking industry's asset quality to remain adequate and in line with those of its peers amid better economic and business prospects.

In terms of industry risk, we believe that Chile has a sound and comprehensive regulatory framework. The banking sector has generated adequate profitability for the past five years, and the absence of significant market distortions results in healthy competitive dynamics. We also believe that Chile's financial system has an adequate funding mix

consisting of deposits, domestically issued debt, and external debt (banks and capital markets). However, institutional deposits have historically played a significant role, especially for mid-size and smaller banks. In October 2018, Chile's Senate approved a new banking law, enacted in January 2019, which aims to align the country with Basel III principles. The law includes the implementation of new capitalization requirements and buffers for banks, to be completed over the next six years. It also introduces tools such as an early regularization plan. Additionally, the law aims to strengthen the financial regulator's governance and autonomy, by transferring the regulatory and supervisory responsibilities from the Superintendencia de Bancos e Instituciones Financieras to the Comisión para el Mercado Financiero, so that regulatory powers for banking and insurance sectors are in one office. At this point, we don't see an impact on potential government support to banks, but we'll monitor changes in the resolution framework.

**Table 1**

Banco del Estado de Chile Key Figures					
	--Year-ended Dec. 31--				
(Mil. CLP)	2019*	2018	2017	2016	2015
Adjusted assets	38,649,190.0	40,023,221.0	37,722,252.0	34,651,509.0	32,415,778.0
Customer loans (gross)	23,999,107.0	23,934,547.0	22,531,470.0	20,745,293.0	19,071,559.0
Adjusted common equity	852,458.9	848,372.8	821,322.2	879,258.8	955,272.0
Operating revenues	361,631.0	1,457,492.0	1,278,285.0	1,243,492.0	1,116,889.0
Noninterest expenses	196,464.0	805,178.0	771,697.0	718,482.0	663,202.0
Core earnings	55,722.0	243,583.0	176,622.0	205,254.0	168,894.0

\*Data as of March 31. CLP--Chilean peso.

### **Business position: Only state-owned bank in Chile, with a sound market presence in segments relevant for the government**

We assess Banco Estado as having a strong business profile given its position as the only state-owned bank. We also incorporate its position as the country's third-largest bank in terms of total loans and the largest in terms of deposits, with market shares of about 14.4% and 20.1%, respectively, as of the end of March 2019. Its scale of operations and broad customer base give Banco Estado significant business stability, making operations less vulnerable to adverse operating conditions than the industry risk score indicates.

Banco Estado follows the government's guidelines for facilitating access to banking products, including transactional accounts, for the low-income population. To comply with the guidelines, Banco Estado has a large presence in the country, with 523 branches and ServiEstado (service centers), 25,400 remote service centers (Caja Vecina), and 2,346 ATMs as of December 2018. Additionally, as of the same date, about 11 million customers use the bank's CuentaRut card, a debit card that cardholders can use for money transfers or for retail purchases. As a result, Banco Estado controls 47% of the debit card market, a significant achievement in offering banking services to Chile's wider population. Retail banking represents about half of the bank's loan portfolio, consisting of mortgages, consumer loans, and credit cards. Commercial banking represents the other half and includes middle-market companies--the bank gained market share in this segment from 2014-2017 but it slightly declined last year due to the bank's countercyclical role.

We expect Banco Estado to continue facilitating credit access for the low-income population and financial inclusion through its remote service centers, digitalization of the CuentasRut debit card, and its continued presence in remote

areas. We also believe the bank will further expand loans to middle-market companies, with higher coverage than private banks, and think it will help foster a savings culture in the country. The bank would further focus on gains in efficiency by improving cross selling (especially to the emerging segments), margins, and funding mix and costs (with more participation in demand deposits).

**Table 2**

Banco del Estado de Chile Business Position					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Loan market share in country of domicile	14.4	14.5	15.3	14.7	14.2
Deposit market share in country of domicile	20.1	21.0	22.0	20.3	20.1
Total revenues from business line (currency in millions)	361,631.0	1,457,492.0	1,278,285.0	1,243,492.0	1,116,889.0
Commercial banking/total revenues from business line	20.9	20.0	22.0	22.8	21.1
Retail banking/total revenues from business line	66.9	69.9	67.4	62.3	59.1
Commercial & retail banking/total revenues from business line	87.9	89.8	89.3	85.1	80.2
Other revenues/total revenues from business line	12.1	10.2	10.7	14.9	19.8
Return on average common equity	9.2	10.7	8.3	10.5	9.0

\*Data as of March 31.

### Capital and earnings: Capitalization metrics hampered by deferred tax assets

The bank's capitalization levels are one of its credit weaknesses. This is because our calculation of its capitalization metrics (RAC, according to our methodology that's aligned with Basel III principles) incorporates the impact of high deferred tax assets. This is due to the bank's high tax burden (as a government-owned entity, it pays 40% in addition to the regular tax rate that other banks pay) and because it can't discount the loan-loss provisions of the tax payment until the loan is written off, amid its high share of mortgages that have low charge-offs.

Therefore, our projected RAC ratio before diversification is about 3.4% for the next 18 months. This forecast incorporates:

- GDP growth in Chile of 3.3% in 2019 and 3.0% in 2020;
- Loan portfolio growth of 5%-6% in 2019 and 2020 (on a nominal basis) taking into account the bank's countercyclical role in the economy and that it has no need to expand credit at this point;
- Slightly lower margins this year given lower inflation levels in Chile of about 2.4%, and then improving with inflation of 3% in 2020. This is in light of Chilean banks' net exposure to indexed currency assets (in Unidad de Fomento [UF]), boosting revenues in a context of higher inflation rates; and
- Weaker asset quality metrics than in 2017 until employment conditions improve.

Capitalization of dividends and potential capital injections into the bank depend on the government's economic policy plans and the bank's adjustments as Chile's new banking law is implemented. Our base-case scenario for the next 18-24 months incorporates dividend payout ratios of 50% (with capitalization of the remaining half of results) and no additional capital infusions.

Banco Estado's quality of capital suffers from the high share of deferred tax assets that account for 55% of total

adjusted common equity as of March 2019. On the other hand, earnings--although modest partly due to the high tax burden--have been steady amid adequate diversification. Net interest income represented 68% of earnings on average over the last three fiscal years, followed by fee income (20%) and market-sensitive income and other income (12%). We expect profitability to continue improving but influenced by the bank's focus on increasing its presence in the small companies and low-income segments.

**Table 3**

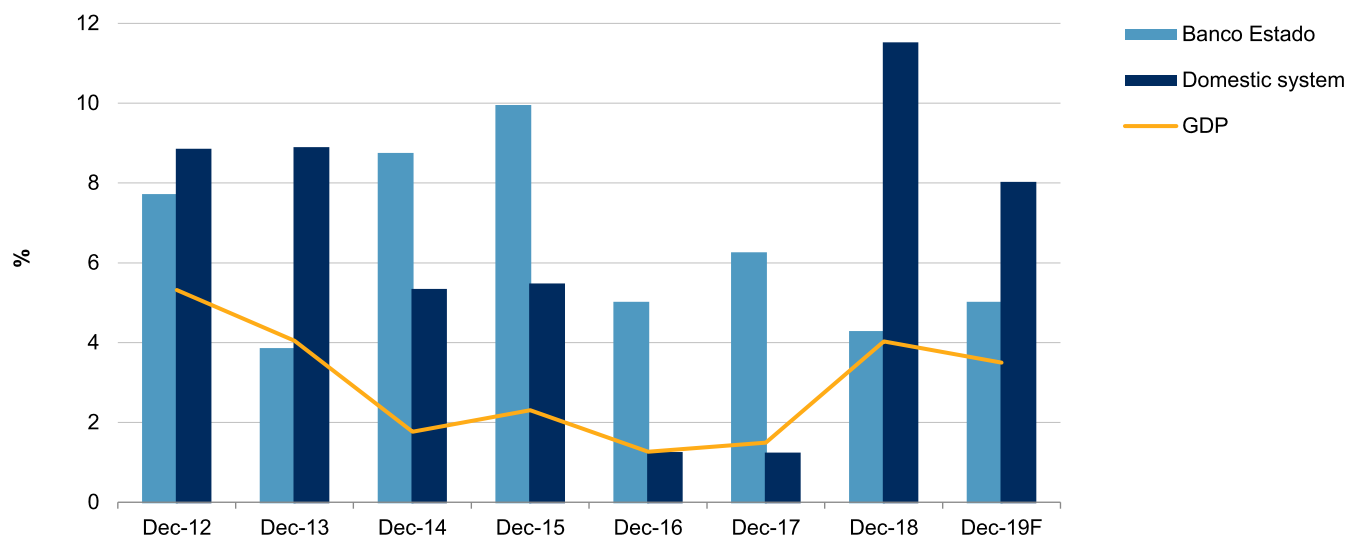
**Banco del Estado de Chile Capital And Earnings**

	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Tier 1 capital ratio	6.9	6.8	7.0	7.0	7.3
S&P Global Ratings' RAC ratio before diversification	N/A	3.2	N/A	N/A	N/A
S&P Global Ratings' RAC ratio after diversification	N/A	2.7	N/A	N/A	N/A
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	69.4	68.2	69.3	67.1	68.2
Fee income/operating revenues	22.3	21.0	20.4	19.1	17.7
Market-sensitive income/operating revenues	7.5	9.3	9.4	12.7	12.9
Noninterest expenses/operating revenues	54.3	55.2	60.4	57.8	59.4
Preprovision operating income/average assets	1.7	1.7	1.4	1.6	1.5
Core earnings/average managed assets	0.6	0.6	0.5	0.6	0.6

\*Data as of March 31. N/A--Not applicable.

**Chart 1**

**Real Credit Growth Versus GDP**



Domestic system excludes Banco Estado. F--Forecast. Source: S&P Global Ratings. Copyright © 2019 by Standard & Poor's Financial Services LLC. All rights reserved.

**Risk position: Focus on lending, with portfolio diversified by economic sector, business segment, and single-name exposure**

We consider Banco Estado to have a satisfactory risk profile thanks to its focus on plain vanilla lending operations, which results from its countercyclical role and a diversified loan portfolio among economic sectors, business segments, and single-name exposures. We expect Banco Estado to continue concentrating on segments where it has expertise, with no significant changes in its lending composition.

The bank's asset quality has been weaker than the industry average given that it's exposed to the low-income residential mortgage segment. The bank shifted its focus to the middle-income segment for its mortgages, resulting in a lower amount of mortgages guaranteed by the government. The government guaranteed about 23% of the bank's mortgages at the end of 2018, generally stable from 2015 but down from 36% at the end of December 2012. As of March 2019, 90-day overdue loans were about 3.6% of Banco Estado's total loans, compared with the industry average of about 2.0%. These metrics compare less favorably to the 3.1% the bank had at the end of 2017. We expect the bank to keep delinquency at similar levels to the current ones for the rest of the year.

Banco Estado also has one of the highest levels of additional provisions among its domestic peers; higher than the regulatory requirement. If we add these provisions to the required provisions, the coverage for the nonperforming loans is about 137% as of March 2019.

**Table 4**

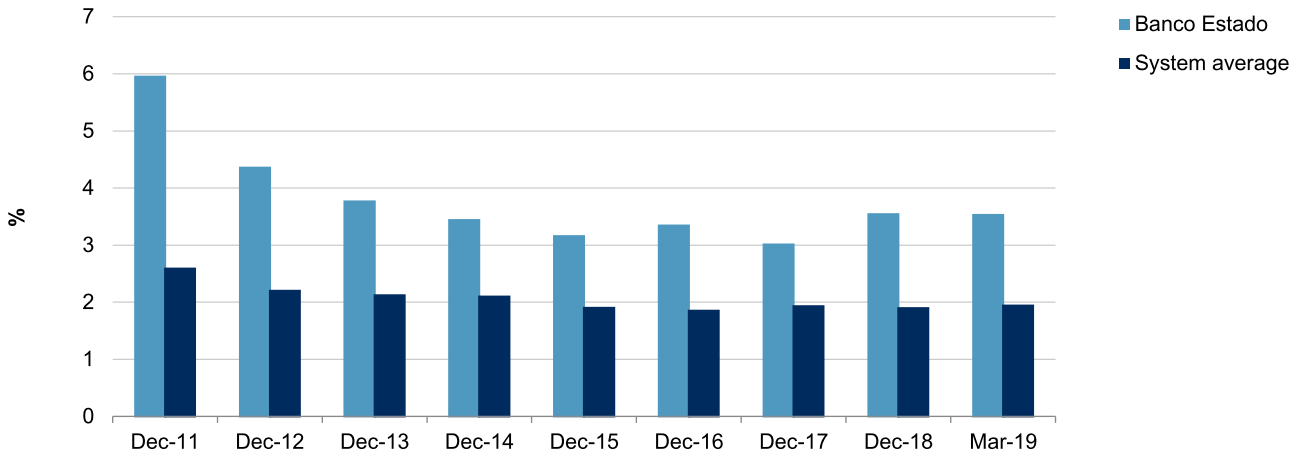
Banco del Estado de Chile Risk Position					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Growth in customer loans	1.1	6.2	8.6	8.8	14.8
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	21.0	N/A	N/A	N/A
Total managed assets/adjusted common equity (x)	45.6	47.4	46.1	39.6	34.1
New loan loss provisions/average customer loans	0.8	1.0	0.9	1.1	0.8
Net charge-offs/average customer loans	0.7	0.7	0.6	0.4	0.3
Gross nonperforming assets/customer loans + other real estate owned	3.7	3.6	3.1	3.4	3.1
Loan loss reserves/gross nonperforming assets	80.5	79.6	97.9	87.7	90.4

\*Data as of March 31. N/A--Not applicable.

**Chart 2**

**NPLs Evolution**

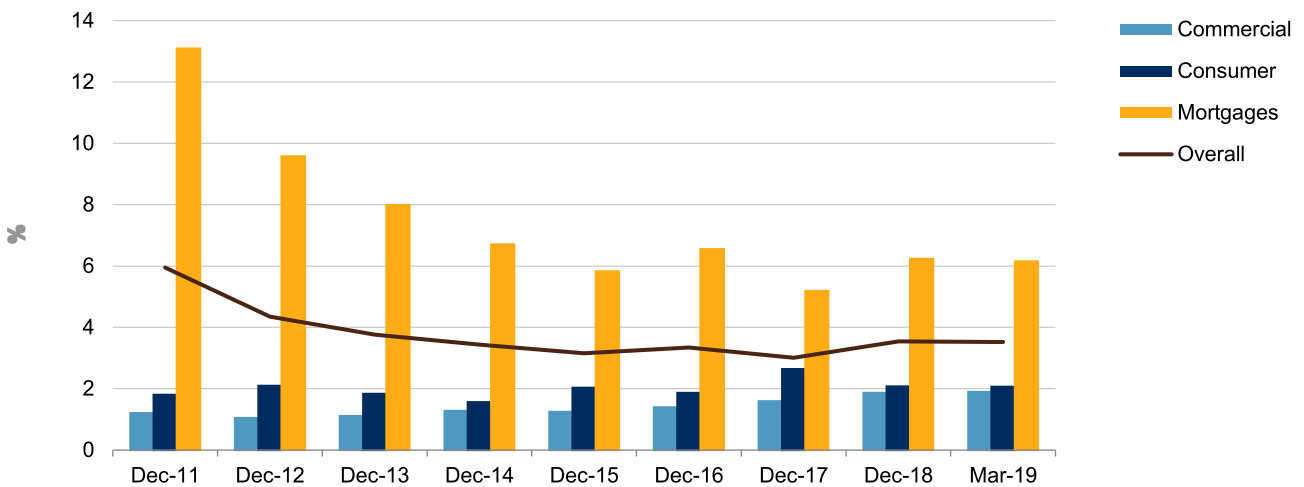
Banco Estado Versus Banking System



Source: SBIF (Superintendencia de Bancos e Instituciones Financieras).  
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**Chart 3**

**NPLs Evolution By Lending Segment**



Source: SBIF (Superintendencia de Bancos e Instituciones Financieras).  
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**Funding and liquidity: Above-average funding structure and strong liquidity compared to peers**

We view Banco Estado's funding as above average. The bank's nationwide distribution network and strong market position result in the largest deposit base in Chile: a competitive advantage given this funding's stability and its lower



cost than other funding sources. As of March 2019, Banco Estado had 20.1% of the system's total deposits, and customer deposits represented about 71% of the bank's funding base. As of the same date, Banco Estado's stable funding ratio was 112%, and has averaged 119% for the past three years. Additionally, the bank sources about 15% of total liabilities from the government either as payment of government employee salaries or as payment to government service providers. The other main funding sources are bonds (senior and subordinated) and bank loans, which account for about 27% of the funding base. Repos make up the remaining 2%. Banco Estado has access to the domestic and international capital markets and to deposits through its branch based in New York, and has access to the central bank's funding if needed.

Banco Estado enjoys high levels of liquidity, as seen in its large portfolio of liquid assets, which include mainly cash and securities from domestic banks and the central bank. The bank's broad liquid assets to short-term wholesale funding ratio is high, almost 2.6x at the end of this March, compared with the average of 3.5x for the past three years, an average that's better than that of the Chilean banking system.

**Table 5**

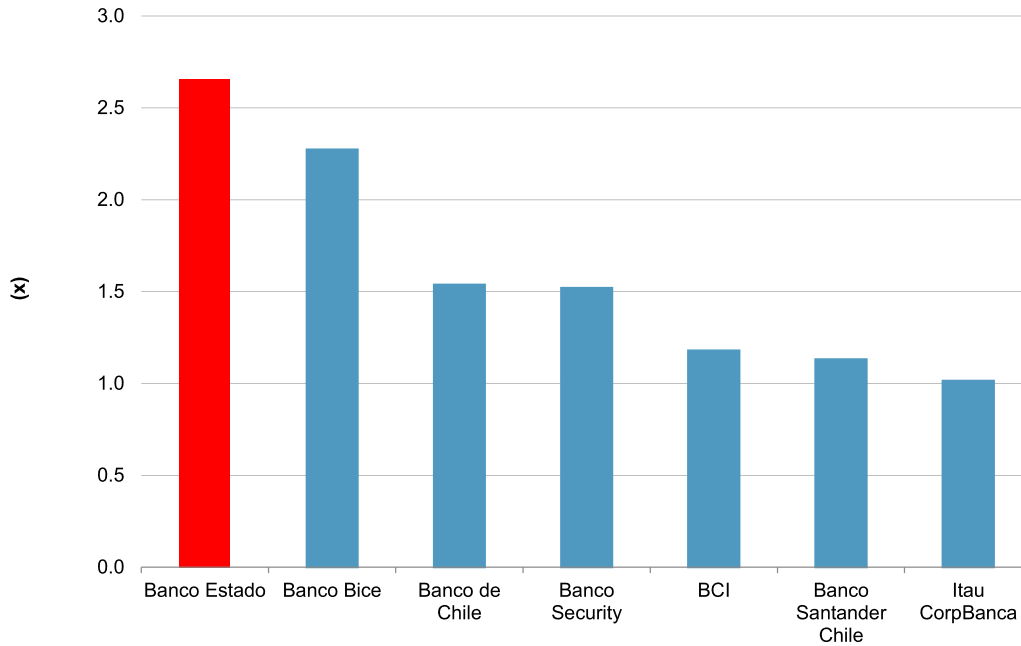
Banco del Estado de Chile Funding And Liquidity					
	--Year-ended Dec. 31--				
(%)	2019*	2018	2017	2016	2015
Core deposits/funding base	71.2	73.3	75.8	74.4	75.5
Customer loans (net)/customer deposits	93.4	87.1	83.9	86.3	83.2
Long-term funding ratio	91.6	92.7	92.8	91.3	94.1
Stable funding ratio	112.0	119.8	121.8	116.9	122.2
Short-term wholesale funding/funding base	8.8	7.6	7.5	9.1	6.2
Broad liquid assets/short-term wholesale funding (x)	2.7	3.6	3.8	3.0	4.5
Net broad liquid assets/short-term customer deposits	20.6	27.2	32.6	32.9	38.9
Short-term wholesale funding/total wholesale funding	30.5	28.6	31.2	35.4	25.4
Narrow liquid assets/3-month wholesale funding (x)	4.8	5.1	8.3	5.0	7.6

\*Data as of March 31.

**Chart 4**

**Broad Liquid Assets To Short-Term Wholesale Funding**

As of March 2019



Source: S&P Global Ratings.  
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**Related Criteria**

- Criteria - Financial Institutions - General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- Criteria - Financial Institutions - Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria - Financial Institutions - Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria - Financial Institutions - Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria - Financial Institutions - Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria - Financial Institutions - Banks: Commercial Paper I: Banks, March 23, 2004

Anchor Matrix										
Industry Risk	Economic Risk									
	1	2	3	4	5	6	7	8	9	10
1	a	a	a-	bbb+	bbb+	bbb	-	-	-	-
2	a	a-	a-	bbb+	bbb	bbb	bbb-	-	-	-
3	a-	a-	bbb+	bbb+	bbb	bbb-	bbb-	bb+	-	-
4	bbb+	bbb+	bbb+	bbb	bbb	bbb-	bb+	bb	bb	-
5	bbb+	bbb	bbb	bbb	bbb-	bbb-	bb+	bb	bb-	b+
6	bbb	bbb	bbb-	bbb-	bbb-	bb+	bb	bb	bb-	b+
7	-	bbb-	bbb-	bb+	bb+	bb	bb	bb-	b+	b+
8	-	-	bb+	bb	bb	bb	bb-	bb-	b+	b
9	-	-	-	bb	bb-	bb-	b+	b+	b+	b
10	-	-	-	-	b+	b+	b+	b	b	b-

**Ratings Detail (As Of June 7, 2019)\***

<b>Banco del Estado de Chile</b>	
Issuer Credit Rating	A+/Stable/A-1
Senior Unsecured	A+
<b>Issuer Credit Ratings History</b>	
14-Jul-2017 <i>Foreign Currency</i>	A+/Stable/A-1
27-Jan-2017	AA-/Negative/A-1+
27-Dec-2012	AA-/Stable/A-1+
14-Jul-2017 <i>Local Currency</i>	A+/Stable/A-1
27-Jan-2017	AA-/Negative/A-1+
06-Aug-2015	AA-/Stable/A-1+
<b>Sovereign Rating</b>	
Chile	
<i>Foreign Currency</i>	A+/Stable/A-1
<i>Local Currency</i>	AA-/Stable/A-1+
<b>Related Entities</b>	
<b>Banco del Estado de Chile Sucursal New York</b>	
Issuer Credit Rating	A+/Stable/A-1
Short-Term Debt	A-1

\*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.

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