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Banco del Estado de Chile

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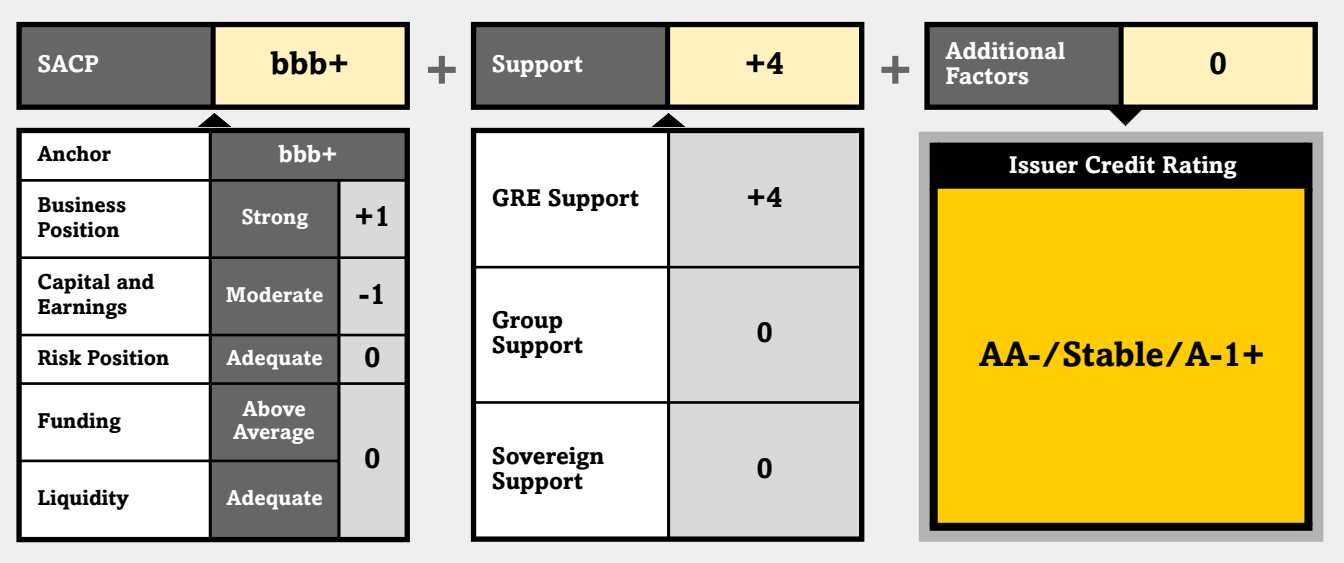

Major Rating Factors

Strengths:	Weaknesses:
• Fully-owned by the government of Chile • Strong business position as the third-largest bank in Chile • Above-average and diversified funding, given its access to a large and stable deposit base • Operations in the low-risk Chilean environment	• Moderate capital position based on our RAC framework • Weaker-than-average profitability • Relatively high dividend payout ratio

Outlook: Stable

The stable outlook on Banco del Estado de Chile (Banco Estado) reflects the outlook on Chile and our expectation that it will maintain its strong market position and its social policy role in the country. We also expect the bank to continue improving its asset quality and maintain its moderate (5%-7%) risk-adjusted capital (RAC) levels. We could raise the ratings on Banco Estado if we upgrade the sovereign and the bank's stand-alone credit profile (SACP). Conversely, we could lower the rating if we downgraded the sovereign or if we downgraded the SACP.

Rationale

The ratings on Banco Estado reflect its "strong" business position, "moderate" capital and earnings, "adequate" risk position, "above average" funding, and "adequate" liquidity (all as defined in our criteria), and our view that there is very high likelihood that Chile (foreign currency: AA-/Stable/A-1+; local currency: AA+/Stable/A-1+) would provide

extraordinary and timely support to the bank in the event of a financial distress.

We base our view of this support on our assessment of Banco Estado's "very important" role, in accordance with our criteria for government-related entities (GREs), as a financial vehicle in promoting banking products and home ownership to Chile's low-income population and the bank's "very strong" link with the Chilean state, which fully owns the bank. Because of these factors, we consider that there is a very high likelihood of support from Chile, and as a result, our issuer credit rating on the bank is four notches higher than its SACP.

Anchor: For a bank operating only in Chile is 'bbb+'

Our bank criteria use our Banking Industry Country Risk Assessment (BICRA) economic risk and industry risk scores to determine a bank's anchor, the starting point in assigning an issuer credit rating. Our anchor for a commercial bank operating only in Chile is 'bbb+'. Chile has an open and somewhat narrow economy with relatively high dependence on commodity exports and a still-low GDP per capita of about $12,500. These weaknesses are partly offset by Chile's strong fiscal performance and low inflation, large external assets, low public debt burden, healthy financial system, relatively well-developed domestic capital market, and ongoing access to the global financial markets. Our industry risk score for Chile is '3', reflecting the country's low political and regulatory risk, which is partly reflected in the adequate banking regulation. In addition, the country has a highly competitive financial system that benefits from a good funding profile and an ample deposit base that finances about 85% to 90% of total loans, and relatively low dependence on external funding, which represents about 10% of the system's total liabilities. Moreover, Chilean banks have ongoing access to long-term funding in the domestic and global markets in inflation-adjusted local currency, which allows them to finance their residential mortgage segment (it represents about 25% of total loans and about 20% of GDP).

Table 1

Banco del Estado de Chile Key Figures

		--Year-ended Dec. 31--			
(Mil. CLP)	**2013***	**2012**	**2011**	**2010**	**2009**
Adjusted assets	22,749,645.0	23,086,332.0	20,840,259.0	18,781,428.0	16,869,698.0
Customer loans (gross)	14,240,046.0	13,894,809.0	12,587,221.0	11,416,303.0	11,078,493.0
Adjusted common equity	1,078,917.0	1,075,023.0	996,916.0	914,772.0	911,112.0
Operating revenues	240,374.0	920,011.0	864,772.0	741,060.0	699,228.0
Noninterest expenses	129,212.0	492,648.0	478,844.0	492,746.0	447,807.0
Core earnings	28,629.0	108,839.0	107,038.0	84,787.0	60,065.0

*Data as of March 31.

CLP--Chilean peso.

Business position: The only state-owned bank; strong market position in residential mortgages, student loans, debit cards, insurance, and micro-business lending

We view the bank's "strong" business position as credit strength in our assessment of its SACP. Banco Estado is the only state-owned bank and the country's third-largest bank in terms of total loans and the largest bank in terms of deposits, with market shares of about 14.1% and 18.3%, respectively, as of March 2013. The bank has a strong market position in residential mortgages, student loans, debit cards, insurance, and micro-business lending. Banco Estado has a social objective of increasing bancarization levels by facilitating access to financial services to the low-income

population. It has a large branch network (345 branches) and Cajas Vecina point of sales (10,289 as of December 2012). In addition, it has developed the CuentaRut card, with about 5.3 million active cards, to better access the low-income population. Retail banking represents about half of the bank's loan portfolio, including consumer loans, credit cards, and mortgage loans. Commercial banking represents the remaining half of the bank's loan portfolio and includes middle-market companies. We expect Banco Estado to continue in facilitating access for the low-income population to its financial services, to slightly decrease its share of residential mortgages, and increase its focus on corporate lending.

Table 2

Banco del Estado de Chile Business Position

		--Year-ended Dec. 31--			
(%)	**2013***	**2012**	**2011**	**2010**	**2009**
Return on equity	10.0	10.1	10.9	9.1	7.4

*Data as of March 31.

Capital and earnings: RAC ratio before diversification of about 5.5%

We currently view Banco Estado's capitalization as moderate. Our projected RAC ratio before diversification is at about 5.5% for the next 18 months. This reflects a base-case scenario that incorporates lending growth of about 9% for 2013 and 2014, stable net interest margin, and continued stabilizing of asset quality. We understand that the dividend payout and potential future recapitalization of the bank depend on the government's future economic policy plans and the economic sectors it intends to promote. However, we expect the government to inject capital into Banco Estado to support its growth, as it did during 2009 when the bank undertook a countercyclical role during the global financial crisis. Banco Estado has adequate quality of capital, with 100% of its total adjusted capital comprising adjusted common equity. Earnings--although modest partly because of the high level of tax the company has to pay as a government-owned entity--have been stable and sustainable, with adequate diversification.

Table 3

Banco del Estado de Chile Capital And Earnings

		--Year-ended Dec. 31--			
(%)	**2013***	**2012**	**2011**	**2010**	**2009**
Tier 1 capital ratio	N/A	7.4	8.1	8.0	8.9
Adjusted common equity/total adjusted capital	100.0	100.0	100.0	100.0	100.0
Net interest income/operating revenues	70.1	69.0	70.5	70.8	68.7
Fee income/operating revenues	20.0	20.1	19.2	19.8	20.0
Market-sensitive income/operating revenues	8.5	10.1	8.7	8.2	6.6
Noninterest expenses/operating revenues	53.8	53.5	55.4	66.5	64.0
Preprovision operating income/average assets	1.9	1.9	1.9	1.4	1.6
Core earnings/average managed assets	0.5	0.5	0.5	0.5	0.4

*Data as of March 31.

N/A--Not applicable.

Risk position: Loan portfolio well diversified among economic sector, business segments, and single name exposures; no material changes in its lending composition

Our risk position assessment for Banco Estado is "adequate." We consider the bank's loan portfolio to be well diversified among economic sector, business segments, and single name exposures. We expect Banco Estado to continue focusing on segments where it has expertise with no material changes in its lending composition, although slightly lower concentration in residential lending, and to expand its lending exposures at a similar rate than the industry average. Like many other Chilean banks, Banco Estado is exposed to a long position in UF-denominated assets (adjusted by inflation) through its mortgage portfolio that benefits from higher inflation levels. In contrast, it has typically shorter tenor liabilities than assets, thus increasing funding costs when interest rates are high (when inflation is high the central bank typically increases the reference interest rate to cut inflation). This provides a partial hedge to inflationary movements. In addition, a large proportion of savings accounts denominated in UF mitigates this risk as well.

Banco Estado's asset-quality metrics, although weaker than the industry average, mainly because of its high exposure to the low-income residential mortgage segment, has shown signs of improvement. Loans 90 days overdue for Banco Estado represented 4.0% of its total loans, compared with the industry average of 2.1%, as of March 2013. Nevertheless, about 37% of the bank's mortgage exposures not only have the residential property as guarantee, but also have a government guarantee for the uncovered amount. Moreover, the government guarantees 47.6% of the bank's non-performing loans of the mortgage portfolio. If we were to deduct the guaranteed mortgage loans from the nonperforming loans, we estimate this ratio would be about 2.1%, which is the same as the industry average.

Table 4

Banco del Estado de Chile Risk Position

		--Year-ended Dec. 31--			
(%)	**2013***	**2012**	**2011**	**2010**	**2009**
Growth in customer loans	9.9	10.4	10.3	3.0	18.8
Total managed assets/adjusted common equity (x)	21.2	21.5	20.9	20.6	18.5
New loan loss provisions/average customer loans	1.7	1.8	1.9	1.0	1.4
Net charge-offs/average customer loans	1.2	1.1	1.2	1.0	1.2
Gross nonperforming assets/customer loans + other real estate owned	4.0	4.1	4.2	5.2	5.4
Loan loss reserves/gross nonperforming assets	66.4	63.9	64.1	55.5	50.8

*Data as of March 31.

Funding and liquidity: One of the largest deposit bases in Chile; stable and relatively low cost funding

We view Banco Estado's funding as "above average." The bank's nationwide distribution network and strong market position allow it to have one of the largest deposit bases in Chile, which represents a competitive advantage, given this funding's stability and relatively low cost compared with other funding sources. As of March 2013, customer deposits represented 78% of the bank's funding sources, and the bank held 18.3% of the system's total deposits. In addition, a high percentage of total deposits are sourced from the government either as payment of government employee salaries or as payment to government service providers. A second main funding source is the issuance of bonds (senior and subordinated), which accounts for about 17% of the bank's funding base.

Banco Estado's loans-to-customer deposits ratio was a relatively low 88% as of March 2013--significantly lower than

the industry average of about 120%. The bank has access to the domestic and international capital markets, and to the Central Bank's credit lines, if needed.

Banco Estado enjoys adequate liquidity, as seen in its large portfolio of liquid assets, which included mainly cash and securities from banks and the Central Bank. This portfolio represented a relatively high 30% of total assets and 41% of total deposits as of Mar. 31, 2013. In our view, Banco Estado's liquidity levels are high relative to the Chilean industry, but similar to other banks operating in Latin America.

Table 5

Banco del Estado de Chile Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2013***	**2012**	**2011**	**2010**	**2009**
Core deposits/funding base	77.9	75.9	74.6	74.3	71.2
Customer loans (net)/customer deposits	87.9	84.9	86.2	87.7	100.1
Long term funding ratio	88.8	86.2	83.9	85.2	81.6
Broad liquid assets/short-term wholesale funding (x)	1.4	3.3	3.4	2.2	1.4
Net broad liquid assets/short-term customer deposits	4.9	19.2	20.8	10.3	3.8
Net short-term interbank funding/total wholesale funding	10.4	(0.5)	1.5	2.6	3.7
Short-term wholesale funding/total wholesale funding	36.6	21.4	20.0	20.2	18.5

*Data as of March 31.

Related Criteria And Research

- Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Group Rating Methodology And Assumptions, Nov. 9, 2011
- Rating Government-Related Entities, Dec. 9, 2010

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 May 31, 2013)		
Banco del Estado de Chile		
Counterparty Credit Rating		AA-/Stable/A-1+
Senior Unsecured		AA-
Counterparty Credit Ratings History		
27-Dec-2012	*Foreign Currency*	AA-/Stable/A-1+
17-Dec-2010		A+/Positive/A-1
18-Dec-2007		A+/Stable/A-1
27-Dec-2012	*Local Currency*	AA-/Stable/A-1+
17-Dec-2010		A+/Positive/A-1
18-Dec-2007		A+/Stable/A-1
Sovereign Rating		
Chile (Republic of)		
Foreign Currency		AA-/Stable/A-1+
Local Currency		AA+/Stable/A-1+

*Unless otherwise noted, all ratings in this report are global scale ratings. Standard & Poor's credit ratings on the global scale are comparable across countries. Standard & Poor's credit ratings on a national scale are relative to obligors or obligations within that specific country.

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