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Research Update:

Banco del Estado de Chile Long-Term CCR Affirmed At 'A+'; Outlook Revised To Positive

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Table Of Contents

Overview

Rating Action

Rationale

Outlook

Related Criteria And Research

Ratings List

Research Update:

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Overview

- On Dec. 16, 2010, we revised the outlook on the Republic of Chile 'AA' local currency and 'A+' foreign currency ratings to positive from stable.
- We are affirming the long-term counterparty credit rating on Banco del Estado de Chile at 'A+'.
- We are revising the outlook to positive from stable after the similar action on the sovereign ratings.

Rating Action

On Dec. 17, 2010, Standard & Poor's Ratings Services affirmed its 'A+' long-term counterparty credit rating on Banco del Estado de Chile and revised the outlook to positive from stable after a similar action on the sovereign ratings. We believe that the higher strength of the Chilean economy to face potential negative effects from adverse external shocks improves Banco del Estado de Chile's overall creditworthiness.

Rationale

The ratings mainly reflect our opinion that there is a very high likelihood that the Republic of Chile would provide extraordinary timely support to the bank in the event of financial distress. We assess Banco Estado's stand-alone credit profile (SACP) to be in the 'a' category.

In accordance with our criteria for government-related entities (GRES), our view of a very high likelihood of extraordinary government support is based on our assessment of Banco Estado's:

- Very important role as a financial vehicle to promote the usage of banking products and home ownership to low-income people (e.g., the bank has the largest branch network, including cities with low economic attractiveness); and
- Very strong link with the Chilean state, including its 100% ownership and its national importance.

Banco Estado's SACP incorporates its leading market position, ranking third among Chilean banks in terms of loans and deposits with market shares of about 16% and 18%, respectively, as of Sept 30, 2010. The ratings also reflect the bank's operations in the low-risk Chilean economy and its large, stable, and diversified funding base. The bank's relatively weak operating efficiency and profitability counterbalance the positive factors.

Banco Estado is the only state-owned bank and the third-largest financial institution in Chile with total adjusted assets of \$37.5 billion as of Sept. 30, 2010, and with presence in almost 100% of the country's geographic area.

Banco Estado's lower profitability than that of its peers hurts its credit quality. This is partly due to Banco Estado's weaker-than-average operating efficiencies and the statutory 40% income tax rate applied to Chilean GRES that is in addition to the 17% income tax applied to Chilean entities (the latter will be temporarily increased to 21% in 2011 and to 18.5% in 2012 to cover the reconstruction costs of the serious damage to the country's infrastructure the massive earthquake on Feb. 27, 2010). The bank's annualized return on adjusted assets reached a low 0.5% (annualized figures) in the first nine months of 2010, which compares unfavorably with the system's average of 1.6% for the same period. Banco Estado has weaker-than-average operating efficiency, as the noninterest expenses-to-total revenues ratio, which remained at 63% compared with peers' levels of 35% to 55%, demonstrates.

Banco Estado's nonperforming assets have deteriorated significantly during 2009 because of the recessionary economic environment and the new accounting standards that mandate that from 2009 onward, the provisioning of the full loan amount if a loan installment remains unpaid for a certain number of days after the due date. Until Dec. 31, 2008, Chilean banks provisioned past-due installments rather than full loan amounts. The nonperforming loans (past due exceeding 90 days) -to-total loans ratio reached a relatively high level of 5.5% as of Sept. 30, 2010. In addition, the ratio of loan loss reserves to nonperforming loans (NPLs) reached only 0.54x. However, the low level of provisions is partly due to the bank's high level of residential mortgages that have certain repayment guarantees from the Chilean government.

Banco del Estado enjoys high liquidity, as evidenced by its large portfolio of liquid assets, which included mainly cash and banks and Central Bank securities. This portfolio represented a relatively high 29% of total adjusted assets, 45% of deposits, and 31% of total liabilities as of Sept. 30, 2010.

Outlook

The positive outlook on the long-term counterparty credit rating on the bank is based on the favorable fundamentals of the Chilean economy and on our expectation that Banco Estado will maintain its strong market position and its social policy role in the country. It also assumes that the bank will improve its asset quality and maintain high liquidity and its large, stable, and diversified funding. An increase in the bank's profitability, in tandem with a sovereign upgrade, could result in a positive rating action. On the other hand, we could lower the ratings on Banco Estado if the bank's market share weakens or if overall credit metrics deteriorate significantly.

Related Criteria And Research

- Bank Rating Analysis Methodology Profile, March 18, 2004

Ratings List

Ratings Affirmed; Outlook Action

	To	From
Banco del Estado de Chile Counterparty Credit Rating	A+/Positive/A-1	A+/Stable/A-1

Ratings Affirmed

Banco del Estado de Chile Certificate Of Deposit	A+
Senior Unsecured	A+

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