

Research Update:

# Banco del Estado de Chile's Stand-Alone Credit Profile Revised Up To 'a-' On Improved Capital Metrics, Ratings Affirmed

March 28, 2022

## Overview

- Chile's government approved a new law under which it guarantees the deferred tax assets (DTAs) generated by the additional tax Banco del Estado de Chile (Banco Estado) pays given that it's a government-owned entity.
- We also don't expect the bank to pay dividends until Basel III is fully implemented in Chile in order to strengthen its capital position.
- Banco Estado's profitability rose thanks to efforts to improve efficiency, lower provisioning needs, and the significant growth in fees generated by its CuentaRut debit account.
- We have revised up our assessment of the bank's capital and earnings to moderate from weak on stronger risk-adjusted capital and earnings metrics prospects, and its stand-alone credit profile (SACP) to 'a-' from 'bbb'.
- We affirmed the 'A' long-term and 'A-1' short-term issuer credit ratings on the bank. The outlook remains stable.

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## Rating Action

On March 28, 2022, S&P Global Ratings affirmed its 'A' long- and 'A-1' short-term issuer credit ratings on Banco Estado. The outlook remains stable. We have revised up our assessment of the bank's capital and earnings to moderate from weak and its SACP to 'a-' from 'bbb'.

## Rationale

Our view of the bank's capitalization has improved because of various factors. First, a new law guarantees a capital injection by the government that equals the amount of DTAs generated by the additional tax the bank pays given its status as a government-owned entity. We also don't expect Banco Estado to pay dividends until Basel III is fully implemented in order to strengthen its capital

position, and its profitability also supports internal capital generation.

The bank generates high DTAs because of its 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. However, the government approved the new law under which the DTAs are guaranteed by the government. As a result, DTAs are not deducted from the regulatory capital following the implementation of Basel III. In the event of any breach of regulatory requirements, the government would capitalize the bank for the guaranteed amount. Moreover, the law contemplates the injection of additional \$1.5 billion between 2023 and 2025. Under our risk-adjusted capital (RAC) criteria, we no longer deduct the guaranteed DTAs and we treat them as convertible DTAs.

Our RAC ratio for Banco Estado before diversification was 5.3% as of December 2021, and we project it to increase to 6.4%-6.6% in the next 18 months. This forecast incorporates Chile's weaker economy in 2022 due to the constitutional amendment discussions that are denting investor confidence, the bank's loan growth of about 6% for the next two years, somewhat lower net interest margins (NIMs), improving fee income following the significant pick-up in 2021, and increasing provisions due to the weaker economic conditions we expect this year. In addition, we don't expect a dividend payout for the next two years.

Banco Estado's quality of capital suffers from the high share of DTAs (64% of total reported common equity as of December 2021), given the tax regime for government-owned entities. However, about 60% of the bank's DTAs are guaranteed by the government, and we don't deduct them from the total adjusted capital that we use for our RAC calculations. If Banco Estado's RAC levels improve but remain near the limit for a stronger category, we may adjust this negatively due to the weaker quality of capital.

On the other hand, Banco Estado's earnings have recently strengthened due to its efforts to improve efficiency and fee income. Net interest income represented 66% of earnings on average in the past three fiscal years (ended December 31), followed by fee income (24%) and market-sensitive income and other income (10%).

Banco Estado's credit quality incorporates our view that there's an extremely high likelihood that Chile would provide extraordinary and timely support to the bank in the event of financial distress. According to our criteria for government-related entities, we base our view of government 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 Banco Estado'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, financial monitoring; and the bank's public policy role. There's also a coordination of debt issuances. Given these factors, we believe that there's an extremely high likelihood of support from Chile. In addition, because of this support, the long-term issuer credit rating on the bank is one notch higher than its 'a-' SACP, while prior to our upward revision of SACP, the uplift was of three notches.

## **Outlook**

The stable outlook on 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 and its subsidiary will move in tandem with those on the sovereign, as long as the bank maintains its SACP at 'bb-' or above (it's currently 'a-'). This support allows the bank to absorb potential deterioration in its credit fundamentals.

## Downside scenario

We could lower the ratings on Banco Estado 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.

## Ratings Score Snapshot

Issuer Credit Rating: A/Stable/A-1

SACP: a-

Anchor: bbb+

Business Position: Strong (+1)

Capital and Earnings: Moderate (-1)

Risk Position: Adequate (0)

Funding and Liquidity: Strong and Strong (+1)

Support: +1

GRE Support: +1

Group Support: 0

Sovereign Support: 0

Additional Factors: 0

## Related Criteria

- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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: Principles Of Credit Ratings, Feb. 16, 2011

## Ratings List

### Ratings Affirmed

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**Banco del Estado de Chile**

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Issuer Credit Rating A/Stable/A-1

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**Banco del Estado de Chile**

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Senior Unsecured A

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column.

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