

Rating Action: Moody's rates A1 Banco Estado's Swiss franc notes

06 Jun 2019

New York, June 06, 2019 -- Moody's Investors Service ("Moody's") today assigned an A1 global foreign currency debt rating to Banco del Estado de Chile's (Banco Estado)'s CHF150 million fixed-rate senior unsecured notes maturing 6 June 2025. The rating has a stable outlook.

The following rating was assigned to Banco Estado's CHF150 million fixed-rate senior unsecured notes, due on 6 June 2025:

Long-term foreign currency senior unsecured debt rating: A1, stable outlook.

RATINGS RATIONALE

Banco Estado's A1 long-term deposit and debt ratings are in line with Chile's A1 sovereign bond rating. The ratings incorporate Moody's assessment of a very high probability of government support in a situation of financial stress, which results in five notches of uplift from its baa3 baseline credit assessment (BCA), to reflect Estado's systemic importance. Banco Estado, 100% owned by the Government of Chile (A1 stable), benefits from full backing from the sovereign even though its obligations do not benefit from explicit government guarantee.

Banco Estado is the country's largest deposit-taking institution and second-largest mortgage lender. The bank plays a significant public policy role by (1) catering to low-income individuals, with an explicit mandate to promote home ownership and national savings, (2) offering financing to small and medium-sized enterprises (SMEs), and (3) fostering financial inclusion and servicing rural areas.

Banco Estado's baa3 BCA benefits from its superior access to deposit funding and low reliance on market funding, supported by ample holdings of high quality liquid assets. The bank's BCA nevertheless is constrained by its low capital ratio, which incorporates high levels of deferred tax assets (DTAs), and modest profitability relative to its peers in Chile, which reflects Banco Estado's large branch network, low yielding loans in line with its policy mandate, and a higher tax burden.

The bank's good asset quality is supported by adequate reserve coverage. While Banco Estado's asset quality has deteriorated since 2017, it will continue to be supported by substantial government guarantees on its most vulnerable portfolios of small and mid-sized enterprise financing and residential mortgages. The nonperforming loan (NPLs) ratio was 3.6% as of March 2019, mainly as a result of higher unemployment levels and lingering effects from the economic slowdown in 2017. However, asset quality will benefit from improved economic conditions in 2019.

Banco Estado's low profitability reflects the bank's social mission, business mix and higher tax rate. Banco Estado's net income of just 0.4% of tangible assets as of March 2019 resulted from structurally high operating expenses related to a large branch network, a loan mix geared towards low-yielding commercial and mortgage financing, its high liquidity, and a higher tax burden, which includes a corporate tax plus an additional tax of 40%.

Although Banco Estado's total regulatory capital ratio of 11.2% as of March 2019 remains comfortably above current regulatory minima, it is among the lowest in the Chilean banking system. Tangible core capital is just 6.9% of risk-weighted assets and would be even lower if Banco Estado's DTAs, which represent about 50% of common equity, are deducted from capital.

RATING OUTLOOK

Banco Estado's A1 rating has a stable outlook, in line with the sovereign rating outlook, because the bank's ratings are at the same level of Chile's sovereign rating. The bank's ratings benefit from five notches of uplift owing to the very high probability of government support.

WHAT COULD CHANGE THE RATING UP OR DOWN

Barring a sovereign upgrade, Banco Estado's senior debt rating is unlikely to face upward pressure even if the bank's fundamentals improve, given that the rating is already at the same level as the sovereign bond rating.

The rating could face downward pressure if Chile's government bond rating is downgraded. Material deterioration in its credit fundamentals could lead to a downgrade of its BCA, but its debt and deposit ratings are not likely to be affected by any change in its intrinsic financial strength because of Moody's assessment of government support.

The principal methodology used in this rating was Banks published in August 2018. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Headquartered in Santiago, Chile, Banco Estado reported consolidated assets of CLP39 trillion (57\$ billion), CLP24 trillion in gross loans, CLP25 trillion in deposits, shareholders' equity of CLP1.7 trillion, and net income of CLP39 billion as of March 2019.

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