

Rating Action: Moody's assigns Aa3 to Banco del Estado de Chile's Swiss franc senior notes

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New York, April 06, 2017 -- Moody's Investors Service has assigned a Aa3 long-term foreign currency senior unsecured debt rating to Banco del Estado de Chile's (Banco Estado) ten-year senior unsecured notes of CHF100 million, maturing on 7 April 2027. The outlook on the rating is stable.

The notes are being issued under Banco Estado's USD3 billion global medium-term note program.

The following rating was assigned to Banco Estado's ten-year CHF100 million senior unsecured notes, due 7 April 2027:

Long-term foreign currency senior unsecured debt rating: Aa3, stable outlook

RATINGS RATIONALE

The Aa3 debt rating incorporates the bank's baseline credit assessment (BCA) of baa2, and the very high probability that the bank would receive government support if it faces severe financial stress in line with the bank's 100% ownership by the Republic of Chile, its significant policy role, and its status as Chile's largest deposit-taking institution and mortgage lender.

As Chile's sole government-owned bank, Banco Estado plays an important public policy role by (i) catering to low-income individuals with an explicit mandate towards promoting home ownership and national savings, (ii) offering financing to small and mid-sized enterprises (SMEs) and (iii) providing banking services to remote rural areas that are not served by private sector alternatives. The bank's mandate also includes the promotion of entrepreneurship and microfinance.

A significant constraint on Banco Estado's standalone strength is its very low level of tangible common equity (TCE), even if we assess a relatively low likelihood that regulators will require it to deduct its substantial deferred tax assets from capital given its government ownership and public policy mission.

The bank's large branch network and the expectation that it would receive government support ensures it advantageous access both to stable core deposits from the largest client base in Chile as well as to the capital markets, providing it a strong funding profile. While Banco Estado's asset quality has improved consistently over the past five years, during 2016, its nonperforming loan (NPL) ratio increased slightly to 3.4% as of year-end 2016, from 3.1% as of year-end 2015, exhibiting the effects of Chile's continued low economic growth and lower repayment capacity of the bank's borrowers. However, Moody's does not expect the bank's overall NPL ratio to deteriorate substantially because of the strong performance of its commercial loan portfolio. However, the baa2 BCA also considers the bank's weak capitalization and profitability. As a result of high operating expenses related to the bank's mandate and extensive geographic coverage, a loan mix geared towards low-yielding commercial and mortgage financing, its high liquidity, and higher tax burden, the bank's net income of just 0.5% of tangible assets is well below that of its peers in Chile. In addition, the Superintendencia de Bancos e Instituciones Financieras (SBIF) reports a Tier 1 capitalization ratio of 7.0%, the country's lowest.

WHAT COULD CHANGE THE RATING UP OR DOWN

Given very high government support, an upward movement on Chile's government bond rating of Aa3 would lead to upward ratings pressure on the bank's debt and deposit ratings. An improvement in the bank's low capitalization could put upward pressure on its standalone BCA. However, this would not affect the bank's senior debt and deposit ratings.

If the Chilean government's bond rating were to be downgraded, Banco Estado's debt and deposit ratings would also be equivalently affected, a result of the substantial uplift related to government support incorporated in the ratings. Downward pressure on the bank's ratings could also emerge if the bank's profitability and asset quality deteriorate substantially, or if prospects for improved Moody's capitalization metric (TCE to risk-weighted assets) remain unlikely, even when the bank continues to comply with Chilean

capitalization requirements.

The last rating action on Banco Estado was on 9 November 2016.

The principal methodology used in this rating was Banks published in January 2016. Please see the Rating Methodologies page on www.moodys.com for a copy of this methodology.

Headquartered in Santiago, Chile, as of year-end 2016 and on a consolidated basis Banco Estado reported CLP34.8 trillion (USD51.9 billion) in total assets, CLP20.7 trillion in gross loans, CLP23.3 trillion in deposits, CLP1.6 trillion in shareholders' equity and CLP147.1 billion in net income.

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