BANCO SANTANDER CHILE

CONFERENCE CALL DEDICATED TO BANCO SANTANDER CHILE FINANCIAL RESULTS 3Q 2021

Company: Banco Santander Chile

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Participants:

- Emiliano Muratore, Chief Financial Officer
- Robert Moreno, Director of Investor Relations
- Claudio Soto, Chief Economist

Operator:

Ladies and gentlemen, thank you for standing by. We would like to welcome you to Banco Santander-Chile Third Quarter 2021 Conference Call on the 29th of October, 2021. At this time, all participant lines are on listen-only mode. The format of today's recorded call will be a presentation by Banco Santander-Chile management team, followed by a question-and-answer session. So without further ado, I would now like to pass the line to the CFO of the company, Mr. Emiliano Muratore. Emiliano, please go ahead, the floor is yours.

Emiliano Muratore:

Good morning, everyone. Welcome to Banco Santander-Chile's Third Quarter 2021 Results Webcast and Conference Call. This is Emiliano Muratore, Chief Financial Officer, and I'm joined today by Robert Moreno, Managing Director of Investor Relations; and Claudio Soto, Chief Economist from our research team. Thank you for attending today's conference call. We hope you all continue to stay safe and healthy.

Emiliano Muratore:

Yet again, the bank has achieved top results with a strong ROE and solid financial performance, thanks to the success of our digital strategy and other initiatives. But before we get into our results, Claudio will start with an update on the economy and macro scenario beginning on Slide 4.

Claudio Soto:

Thank you, Emiliano. Since our last call, sanitary conditions in Chile have improved substantially. Despite the recent surge in daily COVID cases due to the Delta variant, new infections remained relatively low and the mortality rate has receded. That has occurred in a context where more than 75% of the population have received a full immunization program and 25% have got the booster. As a result, the state of emergency that ended in September has not been renewed and most of the sanitary restrictions have been lifted. The economy has surpassed its pre-pandemic level and has reached its potential, although with some heterogeneity across sectors.

Claudio Soto:

Growth has been led by consumption, pushed by government cash transfers and pension fund withdrawals. Investment has also recovered, but has not yet reached its trend. Employment continues subdued with a labor force that is still substantially below its pre-pandemic level. Going forward, we should see further progress in employment as the sanitary condition allow people to resume their participation in the labor market.

Claudio Soto:

Overall, we have revised upward our growth estimate for the year from 8% to 11%. In 2022, growth will moderate to a range between 1% and 2% as the fiscal impulse fades away and base effects kick in. Inflation has accelerated in response to external cost per shocks and one-off hikes in prices of certain services. For the next few months, we should see further increases in inflation due to a buoyant demand at depreciated currency and higher fuel prices. We forecast CPI inflation will close the year at 6.3% and next year will end up between 4% and 5%, converging to the 3% target in 2023.

Claudio Soto:

The Central Bank has accelerated the reduction of its monetary impulse by increasing the monetary policy rate twice since our last call, one by 75 basis points and the other by 125 basis points. Thus, the monetary policy rate has reached 2.75%, significantly above our initial estimate. For the last monetary policy meeting of the year in December, we expect the Central Bank will increase the monetary policy rate by another 75 basis point so that it reaches its neutral level by the end of the year. During next year, the monetary policy rate may rise further, but the Central Bank will graduate the size of future monetary tightening, according to the evolution of domestic demand.

Claudio Soto:

Medium and long-term interest rates have also increased substantially, not only in response to expected tighter monetary policy, but also because of the possibility of a fourth pension fund withdrawal and the uncertainty regarding the political process in Chile. In this context, the peso has depreciated despite favorable copper prices. The government has begun the legislative procedure for the 2022 budget. It considers a significant reduction in expenditures minus 22.5% to reach a public deficit of 2.8%. With this, gross public debt will remain below 40% by the end of next year. The political situation in the country is challenging. In a few weeks, there will be presidential and parliamentarian elections. The results of the presidential election are still wide open and government program of some candidates have been mutating in recent weeks.

Claudio Soto:

In parallel, the Constitutional Convention has approved its internal regulation ratifying the two-third requirement to approve any article. This month, they have begun writing the content of the constitutional text, which should be finished by June 2022.

Robert Moreno:

Thank you, Claudio. We will now move on to explain our strong balance sheet and results.

Robert Moreno:

Moving on to Slide 8, in the third quarter, our net operating income increased 1.2%Q-on-Q and 33.7% on a year-on-year basis. Quarterly net income in third Q totaled 176 billion, an increase of 68% compared to the same quarter of last year. Compared to the second quarter, net income decreased 5%, mainly due to higher other operating expenses. Net operating income, on the other hand, increased 1.2%Q-on-Q. Year-to-date net income increased 63%, with our ROE increasing from 12.5% as of September 2020, to 21.1% for September 2021. Strong client growth, higher net interest income, a strong growth of fee income, improvements in asset quality and cost control drove these results.

Robert Moreno:

On Slide 9, we can see how the bank has significantly outperformed our peers in net interest margin, efficiency, and, ultimately, ROE, demonstrating that these impressive results are not just related to post-COVID reaction but also due to the successful execution of our strategy, especially on the digital front.

Robert Moreno:

One of the most important drivers of our results was net interest income, as can be visualized on Slide 10. Despite asset growth being focused on lower yielding and less risky assets, we still managed to obtain a 13.9% year-on-year increase and NII, with a strong NIM of 4.1% in the quarter. UF inflation in the quarter reached 1.3%. This has triggered the Central Bank to increase the monetary policy rate, as was mentioned by Claudio previously. Consequently, our cost of funds has started to rise and has lowered our NIMs by 10 basis points Q-on-Q. This was compensated, in part, by the acceleration of loan growth in the quarter. Going forward, we expect the monetary policy rate to continue increase, which should put downward pressure on our NIMs. On the other hand, and especially in the fourth quarter, UF inflation should continue to accelerate reaching levels greater than 2% for the next quarter. For this reason, NIMs and 4Q should rebound from current levels and we forecast a NIM level of around 4% for the full year 2021.

Robert Moreno:

As we can observe on Slide 11, total deposits grew 16.2% year-on-year and 1.3%Q-on-Q. In previous quarters we had seen a strong increase in non-interest bearing demand deposits leading to a 24.9% year-on-year increase. Time deposit growth accelerated in the quarter, growing 6.2% compared to June with the increase in interest rates, making this product more attractive.

Robert Moreno:

However, as we can see on slide 12, the interest rate we are paying on this product remains well below that of our peers and far below that of the monetary policy rate, demonstrating our successful management of our cost of funds. Also, on this slide, we show on the right hand side that while there has been a slowdown of demand deposits from our larger commercial clients, growth of retail demand deposits remained solid in the quarter.

Robert Moreno:

On Slide 13, we review loan growth. Total loans increased 3.1%Q-on-Q and 2.5% year-on-year, as loan growth among large corporates started accelerating in the quarter as large corporate start funding in the form of corporate loans as the bond market remain illiquid. Our middle market segment also saw signs of reactivation with loans growing 2.7%Q-on-Q, driven by the acceleration of economic activity in the quarter. Translation gains from the depreciation of the peso and the UF also added to loan growth. Loans to individuals increased 2.6% Q-on-Q and 7.4% year-over-year, driven by mortgage loans that continued to grow solidly at 3% Q-on-Q, and loans from our outer lending subsidiary increased 17.5% as auto sales in Chile have shot upward.

Robert Moreno:

In previous quarters, the SME loan book had seen strong growth due to the FOGAPE and FOGAPE Reactiva programs. In the third quarter, demand for this product continued to decelerate, leading to a contraction of lending to SMEs. As of September 2021, the bank had disbursed 892 billion to the FOGAPE Reactiva program, while the total FOGAPE loan book reached 2.4 trillion pesos. Regarding grace periods, payment holidays, in general, 99.5% of these grace periods are over and only 0.4% of all loans that previously had a grace period or payment holiday are impaired.

Robert Moreno:

Moving on to asset quality on slide 14. In this slide, we can see how the evolution of asset quality remains solid. The NPL and impaired loan ratio continued to show positive trends after the expiration of payment holidays. The coverage ratio of NPLs remained high at 259%. The NPL and impaired loan ratio decreased to 4.7% and 1.2%, respectively. These positive trends were seen across the different products as well.

Robert Moreno:

As we can see on slide 15, these positive asset quality indicators led to a cost of credit of only 1.1% in the quarter.

Robert Moreno:

On slide 16, we take a quick look at non-interest income trends. Fee income had an outstanding quarter, increasing 12% Q-on-Q and almost 20% year-over-year, reflecting the fruits of our digital strategy and strong results from corporate banking. Fee growth was driven by the strong opening of checking accounts, thanks to the popularity of our Life and Superdigital product offerings. Card fees increased 35% year-over-year due to greater card usage while insurance brokerage also grew through our digital platforms. Furthermore, Getnet, our acquiring business that we launched in the first quarter of this year, has already contributed more than three billion pesos in fees since its launch. Total income from financial transactions decreased 17% Q-on-Q. Client treasury activities continued to perform solidly, growing 5.8% Q-on-Q and 17% year-over-year. This was offset by a loss in non-client treasury income due to the execution of various liability management operation to improve NIMs going forward that resulted in initial loss, mainly arising from the unwinding of interest rate hedges.

Robert Moreno:

The rebound in revenues in the quarter was also accompanied by good cost control, as shown on slide 17. Operating expenses decreased 1.4% year-over-year despite higher inflation in the quarter. The year-on-year growth of administrative expenses is due to costs associated to the launch of Getnet and the advance of our digital initiatives in line with our 250 million investment plan for the years 2021, 2023. The depreciation of the peso and the rise in inflation has also negatively impacted our expenses. Despite this, the bank's efficiency ratio reached an impressive 37.7% year-to-date.

Robert Moreno:

Regarding capital ratios on slide 18, the bank finished the quarter with a core capital ratio of 9.6% and a total BIS ratio of 14.2%. At the same time, in October, the bank became the first Chilean bank to issue an AT1 perpetual bond under the new Basel III regulations. The issuance was for US$700 million, and with this AT1 instrument, in October, our Tier 1 ratio will increase by 1.6 percentage points. With our current profitability, we estimate a payout of 50% to 60% of 2021 earnings to be paid out in 2022. We do not rule out that we could pay this dividend in two tranches next year. With the current share price and the forecast for loan growth and ROE, this would signify a current dividend yield of between 5% and 6% for the bank shares.

Robert Moreno:

On slide 19, we can see the requirement of the transition to Basel III year-by-year. The phase-in of Basel III has commenced and will be fully in place by December 2025. The inclusion of market and operational risk-weighted assets will begin in December of this year. By the end of this year, we expect the minimum core capital ratio required for us will be 8.6%, including an additional buffer set by our board with a total BIS ratio requirement of 12.8%.

Robert Moreno:

In the final portion of this presentation, starting on slide 20, we will give an update on our more significant strategic and business initiatives.

Robert Moreno:

Moving on to slide 21, during the quarter, our key digital initiatives continue to advance with great success. This has led to important improvements in profitability, client growth, and satisfaction.

Robert Moreno:

On slide 22, we show how Santander Life and Superdigital are still our heavy-duty products and bringing in new clients to the bank. Total Life clients increased 126% year-over-year, and in 3Q 2021, Life opened over 90,000 new checking accounts, reaching a total of 822,000 clients. Life clients also generated through September 2021, 49 billion pesos in revenue, which shows how this product line not only has a high growth rate, but also a rapid monetization. Superdigital saw record client growth in the quarter, helped by alliances with companies such as Cornershop and Uber as a way of attracting new clients. At the end of September 2021, we reached 215,000, a 95% year-over-year increase.

Robert Moreno:

Further good news came from Getnet, our new acquiring business, as shown on slide 23. Getnet was officially launched in February and has already sold over 40,000 POS, and we sold 19,000 just in the third quarter. An important fact to highlight is that 93% of the clients that are in Getnet are SMEs, our target clients. In just eight months, Getnet already has a market share greater than 15% in POSs. Our NPS score for this product is also strong at 74 points, helping to improve the overall NPS score of the SME segment. This product has been quick to monetize with already three billion pesos generated in fees since its launch.

Robert Moreno:

On slide 24, we show how our digital insurance brokerage platforms also had a positive quarter. Klare continued to expand its product offer with 28,000 insurance policies sold in the third quarter. Coming soon, a new insurance product for cyclists. Autocompara also shined in the quarter. The sale of auto insurance policies to this platform increased 32% year-over-year.

Robert Moreno:

On slide 25, we show how the bank continues its process of transforming its branch network, focusing on the Work Cafe model and closing less productive branches that have low client flow. The Work Cafe are beginning to reopen and we recently opened a new Work Cafe in Puerto Natales, Patagonia. Another eight Work Cafes are set to open during the rest of 2021. With this change in our branch format, coupled with our other digital initiatives, productivity continues to rise with volumes per branch increasing 16.6% year-over-year and volumes per employee rising 16.7% in the same period.

Robert Moreno:

On slide 26, we show the tangible results of our initiatives through the record amount of current account openings. Compared to our peers with the latest information available from the CMF, Santander has opened 630,000 net current accounts compared to only 403,000 accounts in the whole system combined without us. With this, we have been able to increase our market share by almost seven percentage points in 12 months from 22% to 29%. We also show how this improvement in our digital offer is pushing upward our Net Promoter Score. The graph on this slide demonstrates how the bank's NPS has improved during the pandemic as our clients have found high value in our digital product offering. We have overtaken our peers, are now solidly established as number one for NPS in Chile with five points as well in product quality, contact center, and our webpage.

Robert Moreno:

On slide 27, we show how these efforts are translating into record client growth with the introduction of digital products. Coupled with higher NPS scores, in a span of few months, we quickly surpassed the four million client mark.

Robert Moreno:

On slide 28, we show that the year-on-year growth of clients has been driven across the board with total clients growing 14% year-on-year, digital clients increasing 39%, and total clients with a current account increasing 45% year-over-year.

Robert Moreno:

On slide 29, we get into some of our recent developments in the ESG world. Vigeo just finished its annual review of the bank with a rating that puts us in the advanced category with 62 points, evolving from the last time we were overviewed by Vigeo where we were qualified as Robust. We have moved from Robust to Advanced. This is important because, today, according to Vigeo's analysis and scoring system, we are number three among all EM retail banks.

Robert Moreno:

Regarding the ESG topics as well on slide 30, we would like to remind you that you're all invited to our next ESG talk, taking place on Tuesday, November 16, at 8:50 New York Time AM, where top management, including the CEO and the President of the bank, together with other members of the board and management, will present the fascinating updates we have made in these themes and what is to come ahead. There will also be a live Q&A session. We hope to see you there virtually and make sure to sign up.

Robert Moreno:

To conclude, on the next slide, we update our guidance for 2021. The positive results achieved these last three quarters permits us to be more optimistic than we were previously, and we have again revised upward our outlook for this year. As inflation and loan growth continue to gain momentum, we expect to finish 2021 with a NIM of 4.2%, up from 4.1% expected previously. Cost of credit should remain in the range of 1% to 1.1%. We are increasing fee growth to greater than 15% for this year based on the strong client trends already mentioned. Cost growth should remain below inflation and efficiency between 37% and 38% is what we are now forecasting. Taking all of this into account, we are revising our guidance for ROE upwards to 21% for 2021.

Robert Moreno:

At this time, we gladly will answer any questions you may have. Thank you.

Operator:

Thank you very much for the presentation. We will now be entering the Q&A part of the call. If you are dialed in via the telephone, please press star two on your keypad. That's star two on your keypad and wait for your name to be called. If you are dialed in via the web, you may also ask voice or text question. We'll now give a moment or so for the questions to come in.

Operator:

Okay, our first question comes from Mr. Marlon Medina from JP Morgan. Please go ahead, sir, your line is open. Once again, the first question comes from Mr. Marlon Medina from JP Morgan, please go ... Okay, we'll go to the next question. Next question is from Mr. Carlos Gomez from HSBC. Please go ahead, sir, your line is open.

Carlos Gomez:

Hi, good morning, and congratulations on the results. A couple of simple questions. The first one is, at this point in time and given your experience, you had a cost of risk of about 1.1% in the last few quarters. Where do you think that with your current business mix is your normal cost of credit, and when do we get there? Is that a 2022 event or does it come later? Second, and again I understand it's difficult to project now, what do you think your loan growth is going to be for the next two or three years? Thank you.

Robert Moreno:

Okay, hi, Carlos, thank you. Regarding the cost of credit, obviously, you've seen our asset quality has done very well. Our coverage is quite high. Now, we do expect more loan growth slowly flow in? So we think that a normalized cost of credit without considering any type of movements on additional provisions, okay? We would like to keep that stock of voluntary provisions there for any large unexpected event in the future. So our normalized cost of credit would probably be around 1%.

Robert Moreno:

Regarding loan growth, so, remember, last year, we had a rather high loan growth during the pandemic given the different programs, especially SMEs. This year, there's been a really high level of illiquidity in companies and in households, households have gotten a lot of money from pension funds, from direct subsidies from the government, so that had kept loan growth subdued. As these programs come to an end, we think that loan growth should slowly recover. As we said in the last call, and as you saw in the third quarter, loan growth should finish the year around 3% or 4% for the full year. Then going forward, I think, slowly, as the pandemic ends and we enter like a normal economic cycle, loan growth should return to the normal multiplier levels. In general, in Chile, GDP loans to GDP grew around 1.5 times in real terms, and then if you add on inflation, you more or less get the nominal rate we're expecting in the next two to three years. So if the economy grows 2%, 3%, we should be getting roughly around 5% to 7% nominal loan growth in normal years, okay?

Carlos Gomez:

Very clear. Thank you so much.

Operator:

Thank you very much. We will just try once again to open Marlon Medina's line from JP Morgan. Marlon, your line is once again open, please go ahead. Please make sure your phone is unmuted. We'll come back to that one shortly again. Next question is from Mr. Ernesto Gabilondo from Bank of America. Please go ahead, sir.

Ernesto Gabilondo:

Hi, good morning, Emiliano, Claudio and Robert and all your team. Thanks for your presentation and the opportunity. My first question is on the political landscape. Do you think that the voting on the fourth pension withdrawal could be delayed after the elections? Can you provide who are the candidates leading the poll on the presidential elections?

Ernesto Gabilondo:

My second question is on your expectations for the net interest income in NIMs next quarter and next year, considering your expectations on interest rates for the rest of the year and next year and also the one for inflation, where do you see the NIM pressure next year, and When do you see them recovering after the repricing of the loan book? Is this something that we can see maybe at the end of 2022? Or, it should be likely more in 2023?

Ernesto Gabilondo:

Then my third question is on your midterm ROE expectations. Considering that 21% this year, well above the pre-pandemic levels and that you will continue to see high dividend payments, don't you think that the 2022-2023 ROE should be more around the 19%, 20%? Thank you.

Emiliano Muratore:

Claudio, can you take the first one, please?

Claudio Soto:

Yes, sure. Can you hear me? Yes?

Emiliano Muratore:

Yes.

Claudio Soto:

Okay. Regarding the first question, whether the fourth pension fund withdrawal could be voted after the election is not yet clear. Today, in a while, we will know the schedule of the Senate for next week. At that moment, we will know whether it has been put on schedule to be voted next week. If that doesn't occur, there are high chances that it will be voted after the first round. Given that, the chances that it will not be approved are higher.

Claudio Soto:

Candidates leading polls currently are, to the left, Gabriel Boric, and then on the center right, is Kast. In some polls, Kast appears as the first one, but in other polls he appears second to Gabriel Boric, and Yasna Provoste, the candidate from the Christian Democratic Party, is currently in third place in most of the polls

Emiliano Muratore:

So regarding your questions about NIM, as you mentioned, they are the two main factors are inflation and also the short-term interest rates going up. So this last quarter for this year, as Robert mentioned, we are expecting like the quarterly NIM to be maybe between 4.5% to 4.6%, I mean considering the level of inflation we'll have in the quarter, and that will take the full-year NIM around 4.2%. First quarter next year should be, let's say, similar considering the inflation expectations we are expecting for the first quarter, but it's also true that the interest rate will keep going up. The Central Bank, we expect them to hike another 75 basis points in December.

Emiliano Muratore:

So considering all that, we do expect next year NIM to be lower than this year. I mean around like 4%, and if inflation doesn't stay around the 4.5%, 5%, we can get slightly below that 4% for the full year. We do expect by 2023 to have the repricing on the as

Emiliano Muratore:

RAnd regarding our ROE expectations, it connects a lot with the NIM issue and then we still expect, we still see our long-term ROE range from 17% to 19%. If next year, because of the inflation scenario, we are able to sustain NIMs above 4%, it's, let's say, reasonable to have a slightly higher expectation to be in the upper part of that range as you mentioned, but it's going to be mainly related to what's happening on the NII front.

Ernesto Gabilondo:

Super helpful, Claudio and Emiliano. Just last question on the digital landscape. We have been following all your digital initiatives and we have been recently seen that Getnet in Brazil was listed. So, are you exploring something similar to happen in Chile? On the other hand, we have seen that BCI is exploring to launch digital bank. So, is it in your plans to do something similar or do you stick to keep the digital transformation within the traditional bank? I'm just saying you this because investors tend to give different valuations to payment companies and to digital banks.

Emiliano Muratore:

Yeah, I mean we had a good net as you saw, I mean that the numbers are quite impressive. We are really happy with the speed we have got in that business, and there is no discussion yet regarding ownership of this thing. We are just focused on growing and growing faster, gaining market share, I mean taking advantage of being the first mover, you can say, in entering that market after transplant and our priority there is to keep growing, growing fast and gaining market share, and in the future, if there is a new discussion regarding ownerships or listings, then we will discuss it with you but they are not present at this moment.

Ernesto Gabilondo:

And the digital?

Robert Moreno:

Okay. So, yeah, so basically, you're all familiar with our digital initiatives. Obviously, I think that they have all been very, very successful. Santander Life is clearly the key here, and Santander Life is slowly transforming itself into our digital bank inside the bank. So, basically, today Santander Life has been very much focused on the middle income segment. It's growing very strongly and I think a really key thing about Santander Life, unlike a lot of other digital banks that are just beginning, it has rapidly monetized. So, as we said before, already through September, Santander Life is generating income of almost 50 billion pesos, okay? Santander Life, unlike a lot of these other digital platforms in Chile, digital debit cards already has checking account balances probably above $500 million, which is probably all the other digital debit cards in Chile, including Superdigital combined. Life also has a loan portfolio, which hasn't been very aggressive but it surely should slowly start to grow more and more. Life is going to be launching new products, and so, basically, Life inside the bank is going to be expanding and is slowly transforming into our digital bank. But until now it's not going to be a separate entity. It's going to be inside the bank very much integrated with the rest but, clearly, taking over different products and segments. Okay?

Ernesto Gabilondo:

Perfect. Thank you very much, Emiliano and Robert.

Robert Moreno:

Thank you.

Operator:

Thank you very much. Our next question comes from Mr. Juan Recalde from Scotiabank. Please go ahead, sir.

Juan Recalde:

Hi, thank you for taking my question. So my first question is related to Getnet. I think that the fees generated by this business were around two billion pesos in this quarter, and the growth was pretty significant. So my question is, what do you think could be a more normalized level of fees for Getnet? Should we expect this two billion to continue or it will be much higher? What do you think about that?

Juan Recalde:

Then the second question related to the expenses. Expenses looked under control, but I saw that the other operating expenses were up around 76% quarter-on-quarter. You mentioned in the release that the drivers were provisions for non-credit contingencies and also insurance related to cybersecurity related to Santander Life. I was wondering where the amount of operating expenses that we saw in this quarter is going to stay at similar level? Also, if you can quantify what part of those are operating expenses are related to provisions of non-credit contingencies and what part are related to the cyber security insurance?

Emiliano Muratore:

Okay. Thank you for your question. Regarding Getnet, we are in the fast growth phase of the business and then we are growing fast in POS, and also consider that the economy is also in the opening phase, I mean leaving lockdowns behind. So I think that we will keep growing fast in that. It's not so easy to imagine what the stable level of fee will be because, as I said, we are targeting fast growth there. So you can expect fees from Getnet to keep growing as we grow in the number of client, POSs, and also the amount of sales that the merchants are having in this opening phase of the economy. So you can expect growth to stay there for a while and I think we still have some, let us say, quarters ahead before we can talk about stagnation level of fees from Getnet.

Robert Moreno:

Just to add on to what Emiliano said, I think in our digital talk last year, we mentioned that we're looking at around 20 million dollars in fee income from Getnet. So I don't know what the exchange rate we used, but let's say 16 billion would be more, pesos, are normal level versus. So we see a lot of growth and, as you see in the figures, we're growing very quickly.

Robert Moreno:

Regarding your other question, yeah, the other operating expenses, there's a lot of things there, and I'll explain that line. First of all, yeah, there are provisions for non-credit contingency so given that there is still a risk regarding the pandemic and other ... the pandemic is not only credit risk, so we set aside seven billion pesos there. On top of that, remember the last year, there was like a cybersecurity fraud law. So, before, we were very active and selling different kinds of cybersecurity insurance for clients. A lot of that was prohibited or watered down, and the banks have to cover a larger percentage of that, so we have an insurance policy for that, basically. The actual amounts of frauds have gone down per client, but the kind of this insurance policy, the price goes up because the amount of clients are rising. So on like a fraud per-client basis and the actual number of fraud, it's coming down. But since the client base is growing so strongly, it is adding on to that cost. So it's like an indirect costs because of the strong client growth.

Robert Moreno:

Then the other thing there, remember that we still own 25% of Transbank, and even though we discontinued this in 2019, discontinued operations given the losses Transbank has been recognizing, we decided to like do a catch-up and recognized some of the losses Transbank has been accumulating. So that was around three billion pesos. The good news is that Transbank new fee schedule was approved, I think, by the courts so the most likely thing is that Transbank's profitability should begin to turn around.

Robert Moreno:

Finally, remember that auto lending is growing very strongly in Chile. So Santander Consumer Finance, our subsidy for auto loans has had a very large increase in net income. So inside Santander Consumers P&L, an important cost is what they pay the dealers. We have a very strong joint venture with one of Chile's largest car dealers which is SKBerge. So as their net interest income is rising, as their loan growth is rising, also what we paid to SKBerge; therefore, this joint venture is also rising and that's there as well. But that is also included in Consumer Finances P&L. So despite the increase in that cost, the earnings of Santander Consumer are growing very strongly.

Robert Moreno:

So those are the factors, what do you expect going forward? I would say the Transbank thing shouldn't be repeated, the provisions for other contingency is around 10 billion, which shouldn't be repeated, but if we continue to grow strongly in auto loans and in client base, the rest should be recurring. But it has other benefits and other lines, obviously.

Juan Recalde:

All right. That's helpful. Thank you.

Operator:

Thank you very much. Our next question comes from Mr. Yuri Fernandes from JP Morgan. Please go ahead, sir.

Yuri Fernandes:

Hi, everybody. Thank you. I hope you are hearing me because we had issues with connections.

Robert Moreno:

Yes, we can hear you.

Yuri Fernandes:

Hi. Hi, everybody. Good morning. I have a first question regarding the OCI, like your available-for-sale. The results, they were very good, but when we look to the shareholders, that's like equity decreased in the quarter and, I guess, this is related to the sharply increase in interest rates in Chile, like we looked to the 10-year, it was a massive run. So my question here is, what should we expect here going forward? I saw that there were some reclassification from your available-for-sale portfolio to held-to-mature. So can you explore the stock a little bit? I think that would be important for us, like what should happen in the second quarter? I have a second question regarding payments, just some follow-ups, like, regarding Transbank, if you have any update regarding the sale and regarding interchange fee caps. Any updates on that topic? Thank you.

Emiliano Muratore:

Hello, Yuri. Thank you for your question. I mean, regarding the OCI, as you mentioned, I mean the main driver of that has been the sharp increase in interest rate affecting the valuation of our ALCO portfolio. We actively manage our interest rate risk and, mainly, because of that we were able to sustain our NIMs above 4%, I mean, significantly higher than our peers during this last 12 to 18 months when the cycle with rates are very low and going down. Now the cycle changed and then changed quite dramatically in the timing. I mean it was very, very fast change with the Central Bank increasing the rates. I think that's part of the monetary, I would say the typical monetary cycle, because also inflation is going up and that's a positive for us. But maybe the different component this time has been the pension fund withdrawals that basically forced pension funds to dispose all kind of assets including domestic bonds, and so that put a high pressure on rates and affected the value for the ALCO portfolio.

Emiliano Muratore:

Going forward, definitely to project the potential further increase in long-term rates, it's difficult to see increases similar to the ones we have seen so far. I mean, because when you compare Chilean rates to other Latin American countries and other EM countries, we are already, let's say, similar to countries with the much higher level of inflation, a much higher level of risks. So I personally think that there is not much room yet to have rates going up, but also through that, in the short run, there could be some temporary volatility coming from the pension funds withdrawals. I mean, the fourth withdrawal is still to be decided. The interest rates were, I don't know, 40, 50 basis point higher a few weeks ago, then they went down because now you can argue that the market is rising up and also certain probability of the fourth withdrawal to be approved. If it's not finally approved, I think we got to expect interest rates to go down a bit.

Emiliano Muratore:

So let's say summing all that up, going forward, that number will definitely tend to zero because the time will pass, at the end, you can see that as a kind of opportunity cost that even though we don't see that as any potential real loss, but it's showing that today we could buy those assets at higher yields, and that time value of money will be decreasing when time passes, and that negative number will be going to zero basically having a positive OCI for the coming years.

Emiliano Muratore:

Regarding the classification, as you saw in our numbers, there's a part of the portfolio that is roughly 25%, 30% of the portfolio that it's basically being used to fulfill the reserve requirement, the technical reserve requirements, that it's liquidity requirement that every bank has when your demand deposits exceed 2.5 times your total equity, including Tier 2. So, in our case, considering how fast, how high we grew in demand deposits, we are having a, let's say, strong requirement of that case so we need to fulfill that by having sovereign bonds. Also, we need collateral for the Central Bank facilities that were implemented last year to provide liquidity to the system as part of the COVID-compensating measures. So that part of the portfolio, that is definitely held-to-maturity because we don't have an option either to let's say, take the collateral out of the Central Bank, neither to not fulfill the technical reserve requirements. We are having them to maturity and, basically, what we did was to reflect that new business model into the accounting treatment of that part of the portfolio, basically changing those assets from available-for-sale to held-to-maturity, and that's what you saw on our financials.

Emiliano Muratore:

Regarding payments, Robert?

Robert Moreno:

Yeah, so we have no update on the sale of Transbank. So what we did do is we updated the valuation in the P&L, so we don't have any backlog in sense of like we were fully reflecting Transbank's book value in our books. We do own 25% of that, but there is no other further update on the sale there. Regarding interchange fees, well, as you know, the law was passed that governs they're going to fix interchange fees. The commission is working. They already started publishing some of what they're looking at, their methodology, but there is nothing yet. They haven't stated anything yet regarding where actually interchange fees will end up. So I think by March or February, we should have more clarity, but they're working a 100% on that so it's coming for sure by February or March, and probably in the next call we might have a more clear update. But clearly, that will have an impact on card fees next year. We don't know how much yet. The good news is that people are using their cards more intensively, client is growing, and in the long term, the fixing of interchange fees will probably want to permit acquirers, will be better numbers for acquirers like Getnet; and, two, it will probably, therefore, permit the acquiring business and the usage of cards to expand even further.

Yuri Fernandes:

To be clear, you can use the acquired as a natural hedge right, like a higher net for the acquired [crosstalk 00:52:01]?

Robert Moreno:

Yeah. You lose in the beginning, but in the long term, it should let the market expand more.

Yuri Fernandes:

Super clear, thank you very much, guys.

Operator:

Thank you. Our next question comes from Mr. Alonso Garcia from Credit Suisse. Please, go ahead, sir.

Alonso Garcia:

Thank you. Good morning, everyone. Thank you for taking my questions. Most of my questions have been answered, but just wanted to check with you if there is any regulatory change that you are aware of, either at the Senate level or the Congress or the Constitution of Assembly that will affect the banking system? My second question would be regarding the higher interest rate scenario in Chile, I mean, so far, we have seen mortgages continue to grow nicely. I just wanted to hear from you that the margin, you're seeing slower demand on that product given the higher rate scenario going forward? Thank you.

Emiliano Muratore:

Okay. Claudio, can you comment on the regulatory agenda?

Claudio Soto:

Yes. Well, the main initiatives in Congress right now, one is the Fintech law that is at the very early stages, that includes also the regulation of open banking. Then there is a law that was introduced in Congress that puts another cap to the TCM, the cap on the maximum rate you can charge on trade. The law makes some adjustment so that it might be cut even further. Those two initiatives are at the very early stages in Congress and there are many initiatives in Congress that begin its procedure, but then after a while they do not continue. There were many initiatives in Congress that were related to the pandemic that were attached to the declaration of state of emergency. Since the state of emergency was not renewed, those initiatives are now not on the table.

Alonso Garcia:

Okay. Thank you. Sorry, one thing, and Claudio, regarding the constitutional convention or anything if there's any other ...?

Claudio Soto:

Yeah. Well, regarding the constitutional convention, as I mentioned at the beginning, they began writing the text just a few weeks ago. So we are, again, at a very early stage yet. We will have more insights by the first or second quarter of next year. Having said that, the constitutional convention will write down the blueprint of the constitution, which is a very big set of rules. All the details have to be then defined in common law that will take place to occur.

Emiliano Muratore:

Regarding your question about long-term interest rate on the mortgage market, I mean, definitely, the mortgage market has been affected by two main factors. First, the interest rate's significantly higher; I mean, 300, 400 basis points higher than a few months ago. Also, that because of this new environment, many banks, including us, reduce the maximum tenure you can ask a mortgage, I mean, from 30 to around 20 years. So, basically, those two factors are, let's say, making the payments, with the monthly payments, go up by 30%, 40%, even 50% depending on the segments and the tenures, and that is definitely putting pressure on people in the total amount of money they can borrow in order to keep a reasonable relationship between the monthly payment and their salary or their income.

Emiliano Muratore:

So definitely, if we don't see a normalization, I would say, in reduction in long-term interest rate, I think it's going to be very difficult to keep this double-digit growth in mortgages, and that growth will slow down and will, let's say, force people to collect a higher amount of money for their down-payments in order to get into the house. At the end, that's, let's say, will normalize and you will see that shock to be diluted in time. But we are in the middle of that adjustment where you can expect loan growth for mortgages to slow down in this new rate environment.

Alonso Garcia:

Thank you, Emiliano. Just a follow-up on the first question, I mean regarding this proposal in Congress to reduce the interest rate cap further. I don't know if you could provide some more color on? Of course, I understand, it's in a very early stage at this point, that not everything that gets to Congress gets approval, but I mean if you could comment on the likelihood that you see for it to be approved? Who is supporting this law, if it has found further support in Congress, or anything that could help us assess its likelihood of being approved or not eventually? Thank you.

Claudio Soto:

I will touch up on that. As I mentioned, it's at a very early stages in discussion. In the past, we have had initiatives like that more than once and those initiatives just fade away and they do not transform into law. This initiative was put to be discussed in Congress in the context of a more broad law in terms of consumer protection. I see that has to now low probabilities of going through. There are many issues in discussion in Congress right now and this is not really at the top priority in the political agenda. So, I think, as it happened in the past, I see that there are, up to now, low chances that this will effectively be transformed into law.

Emiliano Muratore:

Also, building on Claudio's comments, I agree with his view, considering that also what we just commented on mortgages, I mean, that has resonated on the, let's say, I would say, political environment and, in general, this sense that now people cannot access mortgages as easy as they were accessing them before. That, I think, let's say, people are worried and putting a lower cap on interest rate would also affect credit supply more on the consumer side and not. So I don't see that in this moment there is much room to keep, let's say, restricting or putting pressure on credit supply because that could fight back because, at the end, people need to borrow for their investment plans, for their future plans and I agree that, today, I don't see a high chance of that moving at least fast.

Alonso Garcia:

Very clear. Thank you for the answers.

Operator:

Thank you very much. Our next question comes from Mr. Daniel Mora from Credicorp Capital. Please go ahead, sir.

Daniel Mora:

Hi, good afternoon, and thank you for the presentation. I just have one short question. We observed that during the year, the large corporate segment has presented a reversal of provisions. Can we expect further reversal of provisions in any other particular segment? Thank you so much.

Emiliano Muratore:

Okay, yeah. So, basically, this year, the large corporate segment has seen a reversal of provision and that ... Well, two things there. First of all, last year when we present information by segment, remember, any voluntary additional provisions we don't assign to a segment. They're assigned to a product, but in the segment P&L, they're not included.

Emiliano Muratore:

So last year, during the pandemic, obviously, we were worried about a lot of different segments, different companies, and we downgraded. We were very conservative in downgrading and set aside required provisions for the corporate segment. This year, first of all, a lot of those worries didn't pan out, so some companies have improved their rating and that has resulted in a reversal. Second of all, remember, as we mentioned in the second quarter, I believe, we sold two or three of our largest impaired loans, which had a high provision. So when you sell those loans, obviously, you reverse the provision.

Emiliano Muratore:

So going forward, in the large corporate segment today, has a very, very good asset quality, and given that the economy is recovering we don't expect a large charge of provisions coming out of the corporate. A large reversal so probably not either because those are a reflection more of the selling of these loans. Other segments, no, I would say not a reversal because as the loan growth grows, remember here, every loan is born with the provision so I wouldn't see any reversals in any of the other segments.

Daniel Mora:

Thank you so much.

Operator:

Okay. Thank you very much. Our next question comes from Olavo Arthuzo from UBS. Please go ahead, sir.

Olavo Arthuzo:

Hi, Robert, Emiliano, Claudio. Thanks for taking my questions. But first congratulations for the operational dynamic the bank is showing when compared to the other Latin American bank. But my question is about the Getnet operation in Chile. I noticed that there a lot of [inaudible 01:03:08] question about it. I was just wondering if you could share with us some data related to the acquired operations in Chile then in terms of TPV market share and also point of sale. I mean there are some figures on the press release, but in terms of market share, Robert, if I'm not wrong, mentioned that the market share in POS is 50% nowadays. Can you just please confirm this? Did the market share in terms of TPV increased in comparison to the last quarter and how much it did?

Robert Moreno:

Okay. So, yeah, so there, Getnet has just started. So in terms of POSs, our market share, I believe, today is greater than 15%. We calculate in Chile, there's around 200 and-

Emiliano Muratore:

200,000 before we entered the market, active POSs. Today, we are reaching like 50,000, so yes, I mean, from 15% to 20% market share in active POS.

Robert Moreno:

In active POSs. Remember that around ... We have a lot of small SMEs; a lot of them didn't have a POS. So I think we're expanding the market more than people switching. Some of our clients have switched to our POS, but I think a majority of our clients that didn't have a POS before. So that's very good also from like a margin perspective. But from a total purchase value, I would say today our market share is probably around 4% or 5%, but growing rapidly.

Emiliano Muratore:

Yes, because, also it's important to mention that until last month we weren't entering into the big merchants because Transbank still had their fees fixed and, basically, the big merchants were having low fee that was not attractive to us, so we weren't entering that part of the market. Now that has changed because Transbank finally got the approval to review their fee schedule and so now we are entering into bigger merchants. Also, it's important to mention that, until September, we didn't have our e-commerce solution still operating. Basically, it was all physical transactions and, as you can imagine in this new post-COVID, being out of e-commerce was a big drag for us and that is already part of the past. I mean we are also offering the e-commerce solution and that will also help us to increase the market share in the amount of sales.

Olavo Arthuzo:

That was very helpful. My second question, just wanted to know more about the brick-and-mortar branches of the bank, especially as all the work have [inaudible 01:06:15]. With this positive outlook for the number of changes as you presented on Slide 4, what is the strategy going forward on this physical channel of the bank? There are some intentions to open and optimize some administrative costs? If you could give guidance or give as your metrics or numbers, this would help us a lot. Thank you.

Emiliano Muratore:

Okay. So, yeah, so basically, we're in this investment plan that has different branches, different aspects to it. So we have the whole digital initiatives, Life, Superdigital, Klare, et cetera, et cetera, and part of our strategy is also changing and renewing and modifying significantly the physical network. We've always talked about our digital strategy. So our strategy is very much a mix between a strong digital and a strong physical network, but the physical network, clearly, evolving profoundly over the next few years and the key to that is the Work Café.

Emiliano Muratore:

Today, we basically have, I would say, three type of branches: the traditional branch, the traditional banks like you see in most countries, human tellers, back office, account managers, and people standing in line. Then we have the Work Cafe branch, and then we have the Santander Select, which is the branches for more the mid-high-end, the mass wealthy as you could call it. So when you look at our figures, clearly, the focus of branch closures has been this Santander Select. We've closed most of them. Those are obviously a segment of clients that don't go to the branch so you don't need to have all these branches and a lot of the people, in fact, that work at a Santander Select are shifting to the Work Cafe. The Work Café is very efficient. It's much more efficient than a traditional branch. It doesn't have human tellers. It doesn't have a significant back office. It doesn't have cash. So the branch is fully dedicated to business.

Emiliano Muratore:

So another thing is in a traditional branch, you might have space for three or four relationship managers; in a Work Café, you have space for around 15 to 20. So in a similar space, you have four or five times more relationship managers and you have a much nicer format where our Work Cafés are in something we call the Work Café Community, which is basically a place where mid-market SMEs can go and do business, and where anyone can go and hang out, have a good coffee, see the internet and do business. So the idea basically in the end is to slowly reduce the traditional branch network format. But in order to do that, you have to begin to be able to eliminate some transactions at the branch. A lot of our branches, when you see a long line or something, it's usually non-clients going to get their check, get a cashier's check, getting paid their salary or paying a bill. That is obviously part because we're very strong in cash management.

Emiliano Muratore:

So one way to get people out of the branches who are doing these low value-added services is for those people to be able to get their salaries online. So that's where Superdigital and Life play a very important role. For us to go to company, sign alliances and say, "Okay, today, you're paying workers, a lot of these workers don't have a checking account," and say, "Look, don't pay them anymore or not continue paying them through Santander's transactional service, but deposit them directly through Superdigital or Life," and that way you remove people.

Emiliano Muratore:

Another thing is, as we mentioned in the last quarter, we signed an agreement with Servipag. Servipag has around 200 branches where people can go and cash a check, pay a bill, so we uncluttered the branches. So the idea here is that we don't have a specific number of how many branches we can reduce, but, definitely, the square footages will fall and the amount of branches, which will be shifting away from this kind of like back office, old traditional style, will all be evolving to this more advanced format where, basically, you go to the branch to do business and not to do non-value-added services, okay?

Olavo Arthuzo:

So Robert, putting all together, do you expect the OpEx, especially the administrative expenses to expand above or below the current expectations for the inflation rate of the next year?

Robert Moreno:

Yes, so in the end, if you look at our costs, you can see this is resulting. So we've done a lot of investments, but you see that cost, despite the inflation, are at a low growth rate. So our idea is to continue that trend. Obviously, inflation since two-thirds of our costs are indexed either to inflation or the exchange rate, the depreciation of the best and the acceleration of inflation puts pressure. But with the OpEx that we have, which has a very, I think, high return, a rapid return and it has a very high productivity contribution, our goal in the next few years is to continue growing our cost at or slightly below inflation.

Olavo Arthuzo:

That was very much helpful. Thank you very much, Robert.

Robert Moreno:

Okay, thank you.

Operator:

Thank you very much. Our final voice question, followed by a couple of text questions. This one is from Mr. Brian Flores from Citi. Please go ahead, sir.

Brian Flores:

Hi. thank you for the opportunity to ask a question. Just a quick follow-up on the politics side. Have you heard of any initiatives by any one of the candidates you have mentioned? Sorry, can you hear me?

Robert Moreno:

Yes. Yes, we can hear you. Go ahead.

Brian Flores:

Thank you. Just any initiatives on any of the candidates. You mentioned Boric or Kast that could create certain uncertainty for international investors. It could be capital gains or it could be a particular raise in corporate tax rates. Anything on this that you have heard that is relevant on your point of view?

Emiliano Muratore:

Claudio?

Claudio Soto:

Yes. Well, let me give you some context. This government a couple of months ago introduced a bill to improve pensions, and attached to that bill, there was changes in the tax code including capital gains, taxes on stock transactions that currently are excluded from ... taxes are excluded from capital gain transaction in the stock market, and that bill already introduced them. Now, the bill has not gone through further discussion right now. We are in the middle of political campaign and we have the election right now so it's very unlikely that we'll go further. Boric, in his program, has a very broad tax reform included. His program is changing. He had the program until two or three weeks ago, but then he is producing a new program that is not yet there. But in the original program he has, in order to increase revenues for the government at this broad tax reform that includes lowering aviation basically, increasing taxes or closing certain loopholes, tax on wealth that currently wouldn't have a tax on wealth, so that is more like a personal tax, and also increases in the corporate tax system. But that is part of a much broader package in terms of the tax reform.

Claudio Soto:

The other living candidate, Jose Antonio Kast, does not have a tax hike in his program. He rather has some cuts in taxes in his program. That is more or less what I have in mind. The specific things for the financial sector are not included in none of the programs. Boric had, initially, in his program a revision of international treaties, but his campaign is backing is moving away from that proposal. That was originally in his program, but I think now he's not supporting this idea of revising international treaties that could introduce noise again regarding international investment.

Brian Flores:

Very helpful. Thank you very much.

Operator:

Thank you very much. We have a couple of text questions, which I'll now read out. Perhaps starting with the first one regarding fixed income and bond markets. Should we expect to see you in the bond market next year, either for the AT1? If so, is the plan to have parent by part of the deal? You are soon having ESG Day. What is the appetite for potential ESG-labeled bond?

Emiliano Muratore:

Yeah, so regarding the last part, I mean, we are expecting to finish our ESG framework by the end of the year, maybe early next year. With that in place, definitely, we will try to get as much as we can of our funding from the market in an ESG-labeled format. For that, we think that it's important to have a robust and very formal framework in order to avoid any kind of greenwashing argument or so on. That's why we have been working and I will comment later next month in our yearly talk about that, and I'm not sure-

Operator:

The AT1?

Emiliano Muratore:

I mean we did the AT1 last week. I mean, the parent company participated 100% of that. That has been the policy in the group. With that, we reached our 1.5% of risk-weighted assets in 81 and we have covered the AT1 needs for the next few years. I mean with risk-weighted assets growing maybe in two, three years, we can consider doing another transaction like that. But for the time being, that will be done with AT1 issuances.

Operator:

Thank you very much. There's about five or six questions related to the mortgage segment. I will try to group them. The first one is considering the hike on long-term rates, the mortgage loan growth, do you see the mortgage segment slowing down in 2022? How has it been paving in October? The second one, very related to this, how will the recent increase in interest rates affect the bank and the industry?

Emiliano Muratore:

Regarding mortgages, I mean, I wouldn't say that mortgages would fall, but definitely growth to slow down in October. We have already seen like 20% less of number of mortgages being sold or being signed. With that reduction in the new origination, growth would be slower, but I don't know if it will reach a point where the outstanding will be falling. The new interest rate environment, I mean, the Central Bank hiking rates, higher inflation, it has opposing impacts for banks. I mean, usually, banks have this long inflation exposure and, in the short run, high inflation is positive, but that usually comes with higher short-term interest rate and that hits the NIM, and especially in the short run because you have faster or shorter tenure liabilities repricing and takes between one to two years to have the repricing on assets compensating the initial shock. So far, the impact for us has been like positive because the tightening cycle from the Central Bank has just began and inflation figures have been quite high. That's why for next year, we can expect, let's say, a lower level of NIM because the Central Bank will keep hiking rates and inflation should be lower than this year.

Operator:

Okay. Thank you very much. Next one is related to the mortgages. We saw the bank and others introducing shorter terms for mortgages in recent weeks. When do you think the bank will consider reintroducing the 30-year mortgages, under what scenarios? In line with this, what are the related risks for the construction sector in the coming months, considering buyers potentially putting out of transactions?

Emiliano Muratore:

Yes. I mean, I don't have a specific timing for that. I mean, going back to 30 years will depend on how the market situation evolves in terms of level of rates and also access to capital market in domestic market. So, as of now, we are staying at no longer than 20 years, and I don't have a specific timing to define when to go back to 30 years, if we finally do it, because it will depend on how the market evolves.

Emiliano Muratore:

From the construction market, we have seen that, in general, the markets quite self-adjust. So basically, we will expect the number of new projects to slow down and in order to avoid creating an oversupply of square meters into the market. So we don't have any specific concern regarding that. We think that the sector has gone through other situations like this for different reasons, and it has been able to adjust the supply of new projects to the new environment.

Robert Moreno:

Just adding on to what Emiliano said, during the pandemic, there wasn't very much construction. So, today, the inventory or number of months before inventory would expire is very low. In fact, we're on the opposite side of the cycle, very little inventory available.

Operator:

Perfect. Thank you very much for all this time for questions. We are seeing no further questions at this point. I'll pass the line back to the team for the concluding remarks.

Emiliano Muratore:

Thank you all very much for taking the time to participate in today's call. We look forward to speaking with you again soon. Goodbye.

Operator:

Thank you very much. This concludes today's call. We'll now be closing all the lines. Thank you, and have a good evening.