Banco Santander Chile

CONFERENCE CALL TO DISCUSS BANCO SANTANDER CHILE Q2 2021 RESULTS

Company: Banco Santander Chile

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Participants:

- Emiliano Muratore, Chief Financial Officer
- Robert Moreno, Investor Relations Manager
- Claudio Soto, Investor Relations

Operator:

Ladies and gentlemen, thank you for standing by, and welcome to the Banco Santander the Chile Q2 financial results conference call. Throughout today's recorded presentation, all participant lines will be on listen only mode. The format of the call today will be a presentation by the management team, followed by a question and answer session. So without further ado, I would now like to pass along to Mr. Emiliano Muratore, the CFO. Please go ahead, sir.

Emiliano Muratore:

Good morning everyone. Welcome to Banco Santander Chile's second quarter 2021 results webcast and conference call. This is Emiliano Muratore, CFO, 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. We have a lot of good news for you today. Claudio will start with an update on the economy and macro scenario beginning on slide four, with important upward revisions to our GDP forecast. Then this will be followed by a review of our regular high second quarter results, and the amazing progress we are making in our digital strategy and other initiatives. Finally, we will close with more good news regarding our guidance. Now, I will turn the call over to Claudio.

Claudio Soto:

Thank you, Emiliano. As we mentioned in the last quarter, Chile was going to through a new wave of contagions in April. As you can see on slide four, there was another wave in June. So during the third quarter, a substantial part of the Chilean population was in lockdown. By the end of July, almost 14 million Chileans had received at least one dose of the vaccine, and 12 million had received the full treatment against COVID, that was affecting more than 60% of the total population. Consequently, we have seen a substantial reduction in positivity rate of PCR test and contagions have declined in recent weeks, leading to an opening of the economy and a fast decrease in the population under full lockdown.

Chile has benefited from good external conditions. Our main trade partners are growing fast, and terms of trade have improved.

On slide five, we can see that the corporate price has remained high, having increased almost 50% on average since December 2019. Improvement in sanitary condition is also helping the economy in the short run. Mortality has been normalizing, reaching pre-pandemic levels, and with this, economic activity has also rebounded, growing 18% annually in June. However, employment continues [inaudible 00:02:56] with a decrease in the labor force participation rate, despite an increase in job offerings.

On slide six, we have our estimation for this year and 2022. We estimate GDP will grow between 7.5% and 8.5% this year, favored by the opening of the economy, good external conditions, and liquidity injections to households, to pension funds withdrawals and tax transfers by the government. In 2022, growth will moderate as fiscal impulse fades away. After robust inflation at the beginning of 2021, there was some slowdown due to needed food and services prices. Going forward, the strong dynamic of consumption will put some upward pressure on prices, and inflation should accelerate by the second part of the year, closing at around 3.9%.

In July, the central bank began reducing its monetary impulse, increasing the monetary policy rate from 0.5% to 0.75%. We expect them to continue this trend with the MTR reaching 1.25% by the end of the year. Medium and long term interest rate have also increased in response to a better outlook for growth this year, stock flow adjustment related to the third pension funds withdraw in May, and fiscal pressures on the bonds market due to cash need by the government. Robert, you might continue.

Robert Moreno:

On to explain our strong balance sheet and results, moving on to slide eight, quarterly net income in the second quarter of '21 totaled 185 billion, our highest ever quarterly results, which increased 119% compared the same quarter last year. It is important to point out that second quarter '21 results include an additional provision of 18 billion recognized for increased coverage ratios, considering the uncertainty still surrounding the potential impacts on credit quality of the COVID-19 crisis, especially maybe a future evolution of the Delta variant, which still hasn't arrived in Chile, but you never know. Strong client growth, higher net interest income, a rebound in fees, an improvement in asset quality and cost control drove our results. The bank's return on equity reached 21.6% and surpassed 20% for the third consecutive quarter.

On slide nine, we can see how the bank has significantly outperformed our peers in net interest margin, efficiency, and ultimately, return on equity. This clearly shows that our results are not just due to a post-pandemic recovery, but also due to our efforts on many fronts. 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 13.1% increase in NII with a strong net interest margin that reached 4.2%, driven by an improved cost of funding and a high US inflation of 1.1 in Q2 '21.

For the second half of the year, we expect slightly lower NIMS than the levels reached in the first half, but still about 4%. Going forward, we expect US inflation for the next quarters of around 0.8 to 0.9 per quarter. This will lower asset yield, but we also expect a decrease in the growth rate of non-interest bearing liabilities, as current growth rates are difficult to sustain. The central bank has started to increase the monetary policy, and as Claudio mentioned, we expect further increases reaching 1.25 by year end. Both of these effects should increase slightly funding costs.

On the other hand, we are expecting the asset mix to begin to improve with greater loan growth. All in for the full year 2021 NIMS should be around 4.1%. As we can see on slide 11, the bank outperformed the market and evolution of NII, NIMS, and NIM net of risk, especially since the onset of the pandemic, we generated 520 more million dollars more NII than our main competitor in the last 12 months, reflecting not only our better balance sheet management, but also the strong growth applying deposits, especially checking accounts and the improvement in our cost of funding. As of May 2021, we are generating a net interest margin 50 basis points higher than all of our competitors and a NIM net of risk 20 basis points higher, including the recognition of even more voluntary provisions in 2021.

As we can observe on slide 12, the growth of non-interest bearing demand deposits has been a key force, growing 12.8% in the quarter and 42.8% year over year. This was due to high growth of retail checking accounts, continued strength and the bank's transactional banking services for companies, the positive impacts of the third withdrawal from pension funds, and the emergency family income that more than 80% of Chilean households are now receiving.

On slide 13, on the right hand side, we show how this growth of demand deposit occurred across all segments, with demand deposits and retail banking leading the way and increasing 15% Q on Q, and 52.5% year over year. With this growth, our market share and demand deposits reached 21.4%, placing us solidly in the number two spot in this product. On slide 14, we review loan growth. Total loans increased 0.5% Q on Q, as loan growth remains subdued to the high liquidity levels at the corporate and household. Loan growth in the quarter it was mainly driven by lending to individuals and SMEs. Among SMEs, the main driver was the FOGAPE Reactiva program. In January, the government launched a second phase FOGAPE Reactiva with important Differences compared to the initial program. Reactiva loans can be used to invest in new projects, and not just for working capital. The average yearly rate for a FOGAPE Reactiva is approximately 8.4%, compared to 3.5 for the original FOGAPE program, and maturities can reach up to eight years.

As of June 2021, the bank had disbursed 731 billion pesos in FOGAPE loans, while the total FOGAPE loan book reached 2.4 trillion at the end of June. Loans to individuals increased 1.3% Q and Q, and 4.7 year over year. Residential mortgages increased 8.7 year over year, and 2.3 Q over Q. Consumer loans decreased 1.1% Q over Q as high household liquidity has kept the demand low for this product. A bright spot in consumer lending in the quarter was their outer lending subsidiary Santander consumer finance. Auto loans were up 29% year on year and 9.8% Q over Q. Profits from our outer lending business were up to 200% year over year.

Moving on to asset quality in slide 15. In this slide, we show the breakdown of asset quality by low products. The NPL and impair loan ratios continued to show positive trends after the expiration of payment holiday. The coverage of a ratio of NPLs remains at 252%. The MPL and impair loan ratio decreased to 4.9 and 1.3% respectively. These positive trends were seeing across the different products as well. Regarding evolution of payment holidays on slide 16, as of June 2021, less than 1% of the total loan book was still on the repayment holiday, and of the loans were the payment holiday has expired, 98% have resumed payment, and only 2% have shown some level of impairment. Of the FOGAPE loan book, including the Reactiva program, 97% of this loan book is without payment holiday, and only 1% are overdue on their payment. It is important to point out that the FOGAPE Reactiva in two quarters for the FOGAPE Reactiva, we did not give payment holidays, but do not rule out this option in the future.

As we can see on slide 17, these positive asset quality indicators lead to a positive credit of only 1.1% in the quarter, including the recognition of 18 billion in additional provision. We now have in our balance sheet 168 billion in voluntary provisions to cover unexpected events in 2021 and four. We have not yet reversed any additional provisions. It is important to point out that in April 2021, we also recalibrated some of our internal consumer loan expected loss models, amounting to a cost of 28 billion in provisions [inaudible 00:13:05]. Given the good performance of our portfolios and the high coverage, for the full year we are again improving our guidance for the cost of risk from 1.1 to 1.2 to 1.0 to 1.1%.

On slide 18, we take a quick look at non-interest income trends. Fee income had a solid quarter, increasing 1.4 Q on Q, and 11.2 year over year. The income was driven by strong opening of checking accounts, greater client loyalty, the rise in insurance brokerage, especially through our digital platforms, and a good rebound in various other products and service. Furthermore, Getnet, our acquiring business that we launched in the first quarter of this year is already contributing one billion pesos and fees in the quarter. Total income from financial transactions increased 41.7% Q over Q mainly due to robust client treasury activity. This was offset by a loss in non-buying treasury. We continue to perform various liability management operations, which lowered current results in this line item, which should have a positive impact on names going forward.

The rebound in revenues in the quarter ... One second, please. The rebound in revenues in the quarter was also accompanied by good cost control as shown on slide 19. Operating expenses increased 2.3% year over year below the rate of inflation. The year on year growth of administrative expenses is due to costs associated to the launch of getting it and the advance of our other digital initiatives in line with our 250 million investment plan for the years 2021, 2023. The bank's efficiency ratio reached an impressive 37.5% year to date, and 37.4% in the quarter. Regarding capital ratios on slide 20, the bank finished the quarter with a core capital ratio of 10.1% and a total BIS ratio of 14.7. It is important to remind investors that our capital ratios as of June 21 are net of the 60% dividend payout of 2020 earnings that the bank made in April of this year. This lowered our capital ratios, our ratios in total by 50 basis points. The total BIS ratio reach 14.7% at the end of June.

For the rest of the year, we expect risk weighted assets to accelerate as loan growth picks up, and we estimated payout of 50 to 60% of 2021 earnings depending on the velocity of risk weighted asset growth. With the current share price and our estimated profitability for this year, we expect a solid dividend yield between five and 6%. Once again, this will depend on the velocity of loan and risk weighted asset growth. On slide 21, we give an update regarding Basel III. The phasing of Basel III has commenced and will be fully in place by December 1, 2025. Beginning the first quarter of 2021, banks can already include as 81 capital subordinated debt for up to 1.5% of risk weighted assets. These will be gradually replaced with perpetual bonds in the following years. Under these new requirements, we have transferred 502 billion of sub-debts from Tier 2 to Tier 1.

Inclusion of market and operational risk weighted assets will begin in December 2021. We also present in this slide our assumptions for the phase in a Basel III and the minimum required for the bank. This includes the various buffer, our assumptions for pillar two, and additional buffers to be said by the bank board. In summary, by the end of this year, we expect the minimum core capital ratio required for us to be around 8.6% and a total BIS ratio of 12.8. According to our estimates, we should be well above these levels at year end. And the final portion of this presentation starting on slide 22, we will do an update on our most significant strategic initiatives.

On slide 23, we start by reviewing our strategic objectives for our main stakeholders. This quarter, we would like to focus on the inroads we made regarding gender equality and our efforts related to be the best bank for our customers, gaining their loyalty by leading and digital excellence and experience. On slide 24, we show how in Q2 '21, the bank achieved a milestone regarding gender equality by becoming the first bank in Chile to be certified by the Ministry of Women and Gender Equality as a company that provides equal opportunity policies and practices within the organization. To receive the seal, a company must have tools in place to create a gender-equal environment and a balance between work and personal life. This in line with the UN Social Development Goals, which includes achieving gender equality.

Another valuable achievement was that we were also confirmed as the constituents of the FTSE4Good Index Series. This index is designed to measure the performance of companies demonstrating strong

ESG practice. We are excited to continue to share with you our product progresses throughout the years and improving our ESG initiatives. As shown on slide 25, we have finally set a date for ESG Park. Please save October 14, 2021 in your calendars, for various members on the board and executive team will participate followed by a live Q&A session. We hope you will be able to participate.

Moving on to slide 26, during the quarter our key digital initiatives continue to advance with great success. This has led to an important improvement in profitability, client growth and satisfaction. On slide 27, we shall show how Santander Life and Superdigital are still our heavy duty products and bringing in new clients to the bank. Total Life clients increased 238% year over year, and in Q2 '21 Life open almost 118,000 new checking accounts reaching a total of 729,000 clients. Life continues to be the biggest game changer in Chile in digital banking market, leading to high client growth, rapid monetization, and low client acquisition cost. A large part of these clients continues to be digitally onboarded with a marginal cost close to $1.

Super Digital also continued to show a positive performance and has continue to sign alliances with brands as a way of opening up its client base. Now, Super Digital has an alliance with corner shops, as well as where shoppers can opt to receive the salary on the app with special discounts and gasoline, similar to the alliance with Uber. Clients are also able to receive payment from the government directly to their Super Digital accounts, a key feature during these time. At the end of June 2021, we already had close to 182,000 clients with record account openings in the quarter.

Further good news came from Getnet, our new acquiring business as shown on slide 28. Getnet was officially launched in February 2021, and has already sold over 28,000 POSs, well surpassing our 20,000 goal for the year. An important fact to highlight is that 99% of the clients that have gotten it are SMEs, our target market. Moreover, 63% of the clients have auto-installed their new POS, which demonstrates the efficiency of Getnet systems. Our NPS score for this product is also strong at 80 points, helping to improve the overall NPS score of the SME segment. This product has been quick to monetize, with already one billion generated in fees since its launch.

On slide 29, we show how our digital insurance brokerage platforms also had a positive quarter. They're continue to expand this product offer and our brokers insurance for medical emergencies, oncology, and has launched a new life insurance that incorporates pension savings as well. The amount of alliance with insurance companies also continuing to expand. Autocompara shined in the quarter. The sale of auto-insurance policies increased 25% year over year, with policies sold achieving a 13% cost reduction compared to other platforms.

On slide 30, we show how we continue to forward with our 250 million investment plan for the years 2021, '23 mainly focused on digital initiatives and optimization. The bank is in the process of transforming its branch network, focusing on the work of that model, and closing less productive branches that have low client flow. With these investments, productivity continues to rise, with volume, defined as loans plus deposits per branch, increasing 10.5% year over year, and volumes for employee rising 11.7%. In June 2021, the bank reached an agreement with Servipag, a franchise with over 200 cash payments centers across the country, where clients can cash deposit checks and pay loans, among other cash services. This should free up the branches for more value added services going forward, and help us to accelerate the digitalization of our branch network.

On slide 31, we show how this improvement in our digital offer is pushing upward our net promoter score. The graph on this slide demonstrates how the bank NPS has improved during the pandemic, as our clients have found high value in our digital product offerings. We have overtaken our peers and our well-established is number one for NPS in Chile. On slide 32, we also show the tangible results of our initiatives to the record amount of current account open. Compared to our peers with the latest information available from the CMS, Santander has had a net opening of 501,755 accounts compared to only 217,000 for the rest of the system, excluding us. With this, we have been able to increase our market share by almost 6% points in 12 months, from 22% to 28% in just one year.

In summary, on slide 38, all of these efforts are translating into a high client growth and increased client loyalty. Total clients grew 13% year on year. Digital clients increased 39% to almost 1.9 million clients, and total clients with a current account, including checking and debit increased 45%. Of our total clients, almost more than half our digital clients, meaning they used their online accounts for transactions, to check balances, among other service. The next step is to improve loyalty. Total loyal clients grew in an impressive 8% year over year, and with the inroads made in digital channels and NPS, coupled with the full reopening of our physical network, there is ample room for cross-selling in coming quarters.

To conclude on the next slide, we give some update on our guidance. The positive results achieved these last two quarters permits us to be more optimistic than we were previously, and we have revised our outlook for this year. Regarding loan growth, this should accelerate as the year progresses, with the new cash transfers from the government through the emergency family income, that should last up to September 2021. Loan should remain the lowest single digit, but rapidly accelerating in the last quarter of this year and in 2022. Names will remain at the 4.1 level, as we previously mentioned, slightly higher than our previous guidance. Asset quality is clearly showing positive trends, and we've improved our cost of credit guidance from 1.2 to a level between one and 1.1.

Fee growth should be another important driver due to the reopening of the economy and the success of our various digital initiatives. We expect these to rise eight to 10% this year. Possible regulatory changes always remained the main threat to this forecast. We expect costs to grow in line with inflation and an efficiency ratio of around 38. Finally, all this said, we have risen our ROE expectation from 16 to 18% to 19 to 20%. At this time, we will gladly answer any questions you may have.

Operator:

Thank you very much for the presentation. We will now be entering into the Q&A session. I know that number of callers have already prompted to ask. However, if you have a question, I would like to ask you to press star two on your telephone keypad and wait for your name to be told, that is star two. If you are dialed in via the web, you may also ask a voice or a text question. We'll now give a minute or so for the questions to come in. Thank you. Our first question comes from Mr. Tito Labarta from Goldman Sachs. Please go ahead, sir. Your line is open.

Tito Labarta:

Hi. Hi, good morning, Emiliano and Robert. Thanks for the call. A couple questions. Maybe one following up on the loan growth, I understanding we expect it to accelerate in the fourth quarter. Maybe when we take a little bit in 2022, right, because you have a strong recovery in GDP this year, but you have the cash transfers, which kind of keeps a loan growth rate, I mean, what kind of GDP growth would you expect for 2022, and how would you see loan growth in 2022?

And then a second question on the capital, you're well above the minimum, right? At 10.1, you expect with Basel III, that minimum being 8.6. But by 2025 on the chart here, you expect that to go to 10%. So do you think you'll have to operate with a higher level of capital from the 10.1% you have today over the next five years? Just to get a sense of, is this 10% the right level, and we have to operate around 11. What do you think is the right level for capital, given the increasing requirements for Basel III? Thank you.

Robert Moreno:

Okay. Hi, Tito. So yeah, so loan growth, first we'll start with GDP. So next year, GDP does slow down the growth rate because government spending is increasing very high. I don't remember the exact figure, but I think it's above 20%. But we do think that next year employment should begin to improve, investment should be higher. So all that, and with lower cash transfers and these things, and a more kind of normal economy, they should lead to higher long growth.

So in this year, even though the economy is growing in a probably close to 8%, with the economy growing two or 3% in real terms, going back to more normalized multiplier effects, that should lead to long growth six to 8% in next year, and probably much better long growth in consumer and probably on the commercial side. Mortgage has remained pretty healthy throughout the pandemic. So that's basically the answer. The first question, a normalized multiplier and long growth next year, probably beginning at the end of this year, with GDP growing two to 3% with a multiplier of 1.5 in real terms, plus inflation of around 3%. You get single high digits long growth next year.

Emiliano Muratore:

So Tito, regarding the year your second question about the capital, it's important to mention that that 10% that is on slide 21 already includes 100 basis points of what we call punishment buffer. So that, we are already factoring in their prudent question above the expected regulatory minimum. So having said that, above 10%, we are profitable. I mean, we do expect to be in the long run between 10.5 to 11%, slightly higher than where we are now. But it's also true that with the profitability, we are creating and generated with respect to build that remaining capital in the coming quarters of the year.

So above 10%, we are okay, and maybe we will be moving between 10.5 to 11%. That's a long term [inaudible 00:30:55] ratio. And also that implies that in terms of long term payout, maybe the long term payout is around 50, rather than the 60 or 70 we have had in the last few years in order to keep that 10.5 to 11% CET1 target ratio.

Tito Labarta:

Great. Thanks, Emiliano and Robert, very helpful. So maybe just one follow up then. In terms of the ROE, I know you increased the guidance for this year, but do you think they're 19 to 20% is sustainable, or is this year supported a bit by relatively higher inflation, also cost of risk? I know you lowered the guidance that is that one to 1.1% sustainable, so just thinking about long term models, and if you can sustain this level, or you get back to maybe 17, 18%? So, your initial thoughts on that.

Emiliano Muratore:

We're seeing difficult to sustain this levels of ROE as long terms ROEs, basically, because we have to remember that now, interest rates are going to go up. But that's a way to pressure our cost of funds. Like you said, inflation now, it's relatively high. It might stay where it is for a while, but when inflation conversion to 2%, that will also pressure our name and NII. And in terms of cost of risk, as you also mentioned, we are very low there. We think that we can stay there for a while, but we don't see the 20 plus percent that we asked long term ROE.

Tito Labarta:

All right, thank you very much, Emiliano.

Operator:

Thank you very much. Our next question comes from Mr. Andre Calde from Scotiabank. Please go ahead, sir. Your line is open.

Andre Calde:

Hi, thank you for taking my question. My question, the first one is related to fee income. So you mentioned that the fees were held by Superdigital, Santander Life, and also Autocompara. So I was wondering if you could help quantify this, or to know how big are the fees that are generated by these type of products, or what growth you have seen in the fields generated by those products, or in the medium term, what size of base you expect to win from those products? And the second question is related to the comprehensive income, and based on our calculations, there was a negative impact of around, I think 109 billion Chilean pesos. So I was wondering if you could talk a little bit about the drivers of that and where that can be expected to be rebuilt. Thank you.

Robert Moreno:

Okay, so regarding fee income, effectively, we've been opening more accounts, selling more, especially Autocompara, more car sales. All this you can see, in the end, Santander Life or Santander Life is a big driver of fees, I would say. Superdigital is more of a pass through where we get new clients to eventually move on if they're good clients, other platforms to the bank. But it's tough to say Santander Life should be generating this year around between fees, net interest income between around 60 to 70 billion pesos. Okay? So most of that is fees, but more than fees, most of it is fees, and non-risk income.

So it's spread, we get over the checking account balances that Life already has around 400, 500 billion pesos checking account balances, plus the fees. So that's the bulk of the 70 billion vessels or so that Life is generating in income a year. There's a lot of space to grow on the lending side when on one, this loan demand and also, when we start being a little more open to lending the middle income, Life has the advantage of having the [inaudible 00:35:15] program where we have really good information regarding credit scoring. So Life today is the big generator of income, is the fees, which you basically see in card fees and checking account fees.

Now in card fees, the really interesting thing, not only with Life, but Superdigital is that there's indications that when they open this product, we become their main bank quickly, because that is really driving especially debit card fees. Okay? So a lot of this online purchasing, people going to shops, basically, debit card fees are growing very strongly because of the greater usage, and now, those are the new Life and Santander Superdigital clients.

Autocompara and other insurance you can see on the insurance brokerage last year, it's still not growing year over year, because in May of last year, remember we started in ... we had to adjust some of the prices of our products, especially fraud insurance, we had to recognize a bigger cost there. But if you look on the quarter on quarter, which is a more clean growth, we're growing almost at a 12% annualized basis, and that's where you see the impact, especially of Autocompara. And the good thing with insurance brokerage is that compared to some more loan products, some loan products also come with insurance, that's also going to push that line. So I think insurance brokerages is going to continue to grow.

So basically, we should continue to see good growth in card fees in Getnet, and insurance brokers, and in checking account. Checking accounts, there is the flat fee. These products aren't very expensive from a flat fee basis, but that should begin to add on. Remember last year, we also had to reduce our checking account fees for some time because some of these products included a cyber fraud insurance, which we had to eliminated. As the year progresses, that effect is going to be washed away, and you're going to see the full growth rate of the new clients. So that's why I think these have good outlook going forward. The only negative is regulatory. I don't think anything will come out this year.

The law that establishes the governance for interchange fees has already passed. Okay? So they're going to fix interchange fees. But now, the CMF, the central bank, and the fiscal year national economic, I believe have to set up a committee, define the interchange fees. We don't know what the levels are yet, at least it's a technical committee, but these will be published next year. They have six months. So that could lower fee growth, obviously, but overall, fee growth looks positive going forward.

Emiliano Muratore:

And related your second questions about the OCI in the quarter, I mean, that number is coming from the valuation mark-to-market of our available for sale portfolio, our ALCO portfolio. That is the portfolio we use to banish the interest rate risk of the balance sheet that has been one of the crucial parts of sustaining the names and the NII performance we have had this last 12, 18 months. And what [inaudible 00:38:41] number, our ALCO portfolio is 100% risk free. I mean, we only have sovereign bonds. So we don't see that as a loss, we see that for an opportunity cost that is showing that today, current rates, considering the increase in a long term rates that were produced, in part, because of the pension funds withdrawals, and in part, because of the change in the monetary policy from the central bank, and also in part, because of the behavior or the performance of interest rates across the globe.

We are seeing there an opportunity cost, but we don't ... Definitely, that will revert to in future of business. I mean, it's just a matter of time. The average duration for the portfolio is four years. So basically, that number will go back to zero, basically will become positive going forward in the last years. It's difficult to say if this is the worst. I mean, or we going to have long term rates even higher than where it is. Generally speaking, people don't see farther room for rates to go up because they are now really, really high and the slope of the curve is quite significant. So if rates stay where they are, we will be reverting that number like June. And if rates go up a bit more in the coming months, that we will have maybe a slightly more negative numbers this quarter or this year, and we'll start reverting that starting next year to, let's say go back to zero after the time passes, and the portfolio decays.

Robert Moreno:

And just quickly, you see that in our NII has been growing. We get a very nice risk return on this position. And also in Basel III, today these assets, which was Emiliano said are all Chilean sovereign, risk free, they risk with the 10%, and it's going to go down to zero. So on a risk weighted basis, Basel III, we're getting a very nice spread with zero risk weighting. So that's why we feel so comfortable that this is a very good in terms of risk return reward for us.

Tito Labarta:

Understood. Thank you for the very comprehensive answers. Thank you.

Operator:

Thank you very much. Our next question comes from Mr. Ernesto Gabilondo from Bank of America. Please go ahead, sir.

Ernesto Gabilondo:

Good morning, Emiliano, Robert and Claudio. Congratulations in your results. My first question is on provision charges. As you mentioned in the fourth quarter of 2019, you have been building additional provisions of around 168 billion Chilean pesos. We have seen that reprogrammed loans have shown more deterioration, lockdowns are starting to ease, and then pension withdrawals have helped to maintain asset quality on their control. I understand that you're still concerned about the third, fourth wave. But when you think there could be a possibility to release those provisions, you think this could happen by year end, or it should be more next year? Then my second question is, if you can elaborate on your NIMs expectations, so you continue to have high inflation, which is positive for NIMS. But on the other hand, you're also having or starting to have higher interest rates that could be putting pressure in your cut in funding. So what should we expect for NIMS through the year considering these two variables?

And then my last question is on your ROE. As you mentioned, it has been improved to 19, 20% this year from 16, 18% before. So I think this position the bank and the best one in terms of ROE among the banks, again, already at 19, 20% this year. So where do you see the long term ROE for the bank? Thank you.

Emiliano Muratore:

Thank you, and thank you for your comments and your questions. Regarding provisions, we don't see any relevant terms of emerging voluntary provisions in the coming months. In any case, we would also be considered to revert that maybe in the opposite scenario is to the one you were describing. I mean, we would use the voluntary provisions, basically, if the worst case scenario, or if the situation deteriorates, and we think that the scenario for what the voluntary provisions were built, it's showing up, we would consider to use that. If that's not the case and the situation stays as it is now, or better, we will keep that extra coverage for rainy days looking forward.

And also, if the situation keeps improving and maybe because of an additional pension funds withdrawal, or because of additional help from the government to the households, we still see the underlying costs of risk at low ... When I say low, I say 40, 50 base points of cost of risk. We would consider in to build even extra voluntary provisions to give a not so low cost of risk. Because at the end, we don't think the cycle of the COVID crisis is over. We are more advanced in that cycle. But what we want to have a caution and a reserve to act in case the situation gets better, but we don't see reverse voluntary provisions, let's say in a good case scenario.

Regarding NIMS, as you said, there are many moving parts, but inflation is relatively high, and it's expected to stay high, which is good for NIMS, but the central bank increasing the interest rate is not good for our NIM. And considering their outlook, they will be increasing their rates relatively aggressively in the next 12, 18 months. So they will pressure our name NIM. And then you have on the mix side, you have two realities. On the asset side mix, we should have a tailwind for NIMS, because at the end, today, we are mainly growing in mortgages and the state-guaranteed loans. So spreads are basically very low, and when the consumer activity, let's say revives, and we start to grow in that part of the portfolio, we will have good news of NIMS on the asset side.

On the liability side, it's the opposite because definitely then deposits will be more costly because interest rates are going up. But also the mix effects, we should see demand deposits stop growing at the pace they are growing now, and we can see some migration, if you want, from demand deposits to time deposits, considering that the opportunity cost is higher, and that will also, let's say impact our customer funds. So as we include in the guidance that were NIMS expectations are factoring in all these things are slightly lower than where we are now and going towards 4% as a, let's say more stable level of NIMS, and not staying around 4.2 or 4.3, where we have been lately. And do you want the ROE?

Robert Moreno:

ROE. Yeah. So yeah. So this ties directly into the NIM expectations of they give it that we have 4.2, 4.3 NIMS, which are obviously very good, well-managed. But that is a big driver in the ROE, to reach these ROEs of around 20% this year. So in the long term with the normalization of the NIMS to the next few years, and it depends on long growth of the factors, but around 4%, the long term ROE is closer to 17, 18%. Okay?

Ernesto Gabilondo:

Thank you very much Emiliano and Robert. You also follow up in terms of the potential release of extra provisions. So this could happen more next year, if you are not seeing more waves related to COVID-19. Right?

Emiliano Muratore:

No. Basically, if let's say, let's give you an example. The Delta variant in Chile comes, then it's as a really bad scenario. Okay. But we know that it's temporary, okay, so there are new vaccines will come, people get another shot, whatever. There, you might use it. Okay? So basically, we're saving these provisions, if there's another outbreak and we have a temporary, once again, increase in risk, and that will permit us to use the cushion, more than releasing the ... Now, going forward, everything goes well, and our cost of risk remains at 1%. We could keep those for another unexpected event that we consider temporary. Okay? So if nothing happens, and all goes well, we might not use them. Okay? But our cost of risk should go to 1%. Okay? I think you should see them more as a kind of backstop for us for, let's say really bad cost of risk scenarios, because we will definitely tap them to, let's say contain that really high cost of risk, rather than using them to show extremely low cost of risk because we are tapping the voluntary provisions.

Ernesto Gabilondo:

Okay, understood. So you will keep it for another difficult event?

Emiliano Muratore:

Exactly.

Robert Moreno:

Yeah.

Ernesto Gabilondo:

Yeah. Perfect. Thank you so much. And then you also follow up in terms of NIMS, so NIMS could be kind of stable, considering the inflations, and that offsetting higher interest rates, look at that funding. But then I will say 12 months later, we can start to see the benefits from the increase in interest rates, right?

Emiliano Muratore:

Yeah. So basically, eventually, you get more long growth, yields will go up again. So that's why, I mean, there'll be volatility one quarter and other in NIMS. But overall, around 4% versus the 4.2, 4.3 we're seeing now.

Ernesto Gabilondo:

Okay, perfect. Thank you very much.

Operator:

Thank you very much. Our next question comes from Mr. Sebastian Gallego from Creditcorp Capital. Please go ahead, sir.

Sebastian Gallego:

Thank you. Good morning, and yeah, congratulations on very strong results. I have some questions. The first one, just a follow-up, and maybe if we can go deeper on the rationale behind the way you see accelerating long growth as the year progresses. Why do you see that in a scenario where we could potentially see another round of pension fund withdrawals in Chile? We could see an extension of the IFE support, we could see just the fading effect from the FOGAPE loans, and you also have presidential and the constitutional process going on. I just want to get a sense on why do you see the accelerating progress on long growth. Maybe second question will be related to an investment plan. If you could elaborate on how much have you expand as of today, considering your investment plan from 2021 to 2023. And maybe if I may, the third one, if you could elaborate a bit more on current regulatory risk beyond the interchangeable fees that you recently discussed. Thank you.

Robert Moreno:

Hello, Sebastian. Thank you for your question. I mean, regarding long growth, I would say that, that guidance we are providing implies no further pension fund withdrawals, and no further help from the government, I mean, on top of the ones already announced. And I would say not a significant impact from the Delta variant. So I would say that is, and you can argue, as you pointed out that that is a relatively risky scenario in the sense that it might be too optimistic, because optimistic from the long growth point of view because now, there is a fourth pension fund withdrawal in discussion in Congress, and also the government has stated that they will keep the funds coming for the time that it stated.

So yes, I think it's fair to argue that if any of those things happen, either additional pension funds withdrawals or more fiscal help from the government, we can see as a delay in that rebound in lending. So that's the [inaudible 00:53:31] is true that that would be bad for long growth, but it would be good for inflation cost of risk, and I would say NIM coming from inflation, and also cost of risk. So it's not, let's say such a bad scenario for us, and you can expect the long growth rebound to happen when all these things stop happening, I mean, all these withdrawals or fiscal stimulus from the government.

Emiliano Muratore:

And yeah, just to add on real quickly, there's also the growth of investment. So GDP is fluctuating because of the government help and consumption, but investment should be accelerating. So you're going to see a rebound in commercial loan. In fact, we're starting to see that in the bank currently. So it's also the third event, which is the external growth of the world economy. So that will definitely have an impact [crosstalk 00:54:34]. Okay.

Sebastian Gallego:

Emiliano-

Emiliano Muratore:

Regarding the ... Please go ahead, sorry.

Sebastian Gallego:

Well, yeah, one element, an additional element is that in last year, we saw an increase in the leverage because the contraction in GDP was much stronger than the evolution of loans. What we have seen during this year is a process of the de-leveraging. Our association of long growth are consistent with the de-leveraging process to go back to the situation we had previous to the pandemic. That is more or less what is implicit here. So still, somehow the slower growth of loans than GDP in the next few months, but then picking up as these de-leveraging process can stop.

Emiliano Muratore:

Yeah. And then regarding investment plan, it's more or less even now one third per year. So we've had more or less one third of those 250 million. We're going to expand this year. A lot is going to automization, digitization, among other products. But I think this year the big focus is automatization and to make the back office processes in the center offices, corporate center all much more and more efficient. And then in the next few years, we'll be seeing a bigger transformation of branches, and obviously, launching of new products and services. So there are other interesting things coming.

Regarding regulatory risks, we mentioned the regulation of interchange fees. So that's a reality. We are there. They're setting up the governance of how to do that. I think as we said before, an important thing there is that this is done by technical committee. So the process, there will be an impact. But we don't know how much, but I think the whole process in the end is better than what we initially thought. But we have to wait till next year when they have six months to figure these things out. In other regulatory risks, well, in the last call, we talked about the VAT tax reductions, fuel. I don't know, Claudio, I don't know if you have any update regarding the taxes and the how that may be impact inflation, if there's any new things there.

Robert Moreno:

No. What was voted this week was the reduction of the tax on materials, but it was rejected in the commission at the house. We still think that there is little chance that tax reductions and fuel, and the reduction will pass the Congress.

Emiliano Muratore:

Yeah. And in terms of regulatory risk, apart from the interchange fees that we will know them maybe later this year or early next year, but then when you go to the traditional playbook of potential regulations affecting banks, here in Chile, we are relatively advanced. I mean, we have gone through most of them. I mean, from interest rate caps, I mean, we also now have also three implemented with capital requirements going up. You have the freeze on fees. So at the end, apart from their interchange fees, there is nothing on the table right now. It's not so easy for us to foresee any potential piece of regulations to the ones that we have already known, and are already in place.

Sebastian Gallego:

Perfect. Thank you. Very clear.

Operator:

Thank you very much. Our next question comes from Olaver Arthuzo from UBS. Please go ahead.

Olaver Arthuzo:

Yes. Thank you Emiliano, Robert, Fernando for taking my question. I have to make the first one. As we know, Santander Brasil are releasing yesterday their quarterly results with the constantly dated banks earnings suprise from Getnet. So we know that the foreign company business started its operations in Chile at the beginning of this year on their new SIM strategy. Please, could you share with us some potential numbers that Getnet could achieve in Chile? I mean, after the guidance revision and your conversation with the market for expense. How much is the Korean market share of the company in terms of financial volume transacted, and how much it could reach in the following years? And if you could talk about the share, the market share, and number of POS, I would appreciate it as well. Thank you very much.

Emiliano Muratore:

Thank you for your questions. I mean, in terms of Getnet, I mean, that has been a really successful story for us in terms of the market share in terms of transactions is still, let's say building up. Then we also have to consider that we are in the middle of the pandemic. We are still to launch the eCommerce leg of Getnet. Definitely, that has been a drag. But even with that drag, we have already reached 15% market share in terms of POS in basically four months. We are growing at a very good pace. And also, it's important to mention that at the beginning, we started basically using the existing clients, and then [inaudible 01:00:46] to sell a POS. But now, it has been a very successful strategy to capture new clients. So we are capturing new clients to the bank, and also including Getnet in their solution.

And so our ambition in that market is high. I mean, we expect to keep growing market share, and definitely be one of the relevant players in the acquired market, which is a very, let's say active market here now in Chile because there are a few other banks who have announced to enter the market. But I think we have some kind of advantage of first over advantage in growing faster and earlier, and we expect to be one of the leaders there.

Claudio Soto:

Sorry. We want to reach 15% market share. Our market share now is like 3%.

Robert Moreno:

Oh, then the POS is 15.

Emiliano Muratore:

[crosstalk 01:01:49]-

Robert Moreno:

Yeah, 15. Yeah.

Emiliano Muratore:

... in terms of transaction.

Robert Moreno:

Yeah, yeah. Okay.

Emiliano Muratore:

I mean, because today we have roughly 30,000 POS installed, active POS is from Transbank around 200,000 plus. Basically, Transbank was the only relevant player. So let's say we are already close to 15% in terms of POS, and the share in transactions and activity will only go up when the pandemic, let's say goes away, and also when we implement the eCommerce solution that will definitely be a game changer because they are, as we all know, a big part of the economy now, is operating in eCommerce, and not having that part of the solution. It's a big drag, but we expect to go out to the market with that in the coming weeks.

Olaver Arthuzo:

Okay. And sorry, guys, just for me to have a clear view on this, is 15% in terms of POS, and 3% in terms of financial transactions? Is that right?

Claudio Soto:

That's right.

Emiliano Muratore:

Yeah. Yeah. And that's in part because of the early stage we are, and also because we haven't gotten into big retailers and big ... 99% of the clients are SMEs, so money-wise, that number will, let's say, stay low as far as we don't get into the big retailers with the, let's say the big amounts of transactions and sales.

Olaver Arthuzo:

Okay, okay. And do you have any potential objective or guidance as for a potential market share in terms of financial transaction [inaudible 01:03:37]?

Emiliano Muratore:

As I said, I mean, our ambition is high. But it's also important to have the right economics. And today, let's say with the current market conditions, considering the MDRs that the big retailers are getting, and the interchange fees in place, it's not, let's say, profitable to get into that. So when we get the right economics in terms of MDRs and interchange fees to get into that, we can expect to be also one of the leader players in terms of transactions, and not only POS. But as I said, I mean, that will depend on having the right economics. As of today, basically, it's possible to make money, and we will get into that, and we can expect to have, I don't know, a big number of market share in transactions, but when the economics to get into big retailers are adequate.

Olaver Arthuzo:

Okay, thank you very much for this. And my second question, I would like to talk about operating expenses, more specifically about the branch. As we could see in the release on this quarter earnings of the bank, it reduced in 23, the number of the branches in this quarter. And given now the ramifications of the provider spread, what could you tell us about the second half and the next year in terms of this physical strategy? So in other words, if some of the banks pipeline to reduce even more of this number of operations, and if you could also put the role of what caused that on this context, it will help us a lot.

Robert Moreno:

Okay. So yeah, and as you saw on the slide, we showed a branch had fallen by 6% or so. Mainly what we've done more recently is, we've closed Santander select branch for the middle, high income, okay? But basically, because these branches, first of all, most of them weren't at the street level, and given the pandemic, and given the advance of digitization in Chile, these branches, a lot of people didn't go to these branches. So there's a lot of room to consolidate square meters, so the main closures have come from there. In fact, we've gone from 34 to 13 Chile branches, and so that's obviously a key area where we're going to continue to evaluate given the behavior of client. Okay?

Now, the other thing we've done, we've opened a couple of work cafes. Now, the work cafe is going to speed up again when they can reopen. The work cafes are working. The front office is working. Their business is open, but the co-working spaces are still closed. So I think when we continue advancing with the pandemic, we're going to reopen the co-working. It takes like two weeks to get that thing up and running. So that will be an important milestone in the second half of this year, and then we're going to continue with the process of branch transformation.

And here, the key thing with the work cafe, apart from it being a really nice format where a lot of people come to the work cafe to do business, is this work also has a very nice digital format, which in itself is very profitable. Okay? So going forward, we're going to use a lessons learned from the work cafe to continue transforming the rest of the division of branches. Some of them will have a big co-working space, some of them will not. But the digital format of not having that many human tellers having no back office, no vaults, that is something that is already developed in the work cafe format.

But at the same time, if these branches, these digital branches, which are probably smaller and more efficient are very productive, we could actually increase our openings in the future. What is clear is that things will be more efficient, and the square meters will fall, but not necessarily the number of branches, okay? So overall, there is going to be a big process in the next few years of the digital transformation. We have like, of the 344 branches, 272 what we call traditional standards, the old branch. There, there is a lot of work to do, and that's where the bulk of investments going forward are going to be.

And another important thing we mentioned is this agreement with Servipag. So this agreement is actually very important because today, a lot of branches, we're very strong in cash management. And let's say we have a large construction company. They pay their workers with something there, and a lot of these workers are still an important portion, do not have a checking account, or a debit card account, or they prefer just to receive their monthly salary in cash. So at the end of the month of the day they're paid, we have a lot of our branches which are cluttered. So this agreement with Servipag will permit a lot of people who do things that our branches will have 200 more cash payment centers to pay bills, to get their salary, to pay loans, et cetera.

So this will really permit us to move forward more rapidly in the transformation of our branches. Okay? So that's going to be an important process going forward, which will permit us to be more and more productive, and definitely lower square meters. I don't know how many branches will be closed, but definitely, the branches will be much more effective and much more productive.

Olaver Arthuzo:

Very clear, Robert, thank you for this, and thank you all, guys.

Emiliano Muratore:

Okay, thank you.

Operator:

Thank you. Our final question today looks to be from Mr. Abraham Martinez from Fitch Ratings. Please go ahead, sir. Oh, just once again, Mr. Abraham, your line is open. Just please make sure your microphone is enabled. Okay, once again, Mr. Abraham. I think Mr. Abraham has dropped. He was reconnecting. We'll give maybe another 10 seconds.

Claudio Soto:

Okay, we'll wait 10 seconds, and then I'll call him.

Operator:

Okay. Okay, looks like we have no further questions. I'll pass the line back to the management team for their concluding remarks. Thank you.

Claudio Soto:

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

Operator:

Thank you. We will now be canceling the call and closing all lines. Thank you.