

Transcript of a Conference Call on Grupo Security Results as of September 2015

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Mr. Renato Peñafiel (CEO of Grupo Security)

Our investor relations team is here, Fernando Salinas (Planning and Development Manager at Grupo Security), Marcela Villafaña (Head of Investor Relations), Pedro Bralic (Investor Relations Analyst) and Roberto Tresoldi (Deputy Management Control Manager at Grupo Security). Also with us today is Manuel Widow (Planning and Management Manager at Banco Security), who is responsible for the research department at the Bank; and Rodrigo Guzmán (CFO at Vida Security), who has the same responsibility at the life insurance company. So, I would like to present an overview, and certainly feel free to ask any relevant questions on any the topics.

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Starting with the macroeconomic environment, the only thing that I would like to convey is that over the last few months an opinion has been gathering strength that GDP growth will be very poor this year. We think that unemployment is going to grow next year, at least these are our projections. A higher inflation rate than originally thought, and an exchange rate that has been impacted by domestic economic performance and by what is happening on the international markets. Therefore, the macroeconomic situation has been deteriorating, particularly in the second half of the year compared to the first. I would say that this deteriorating macro situation has begun to hit the finance industry, in fact it is clearly hitting the world on some of these fronts. This means that market rates have been rising, that the volume of new loans has been slowing down, and in some way, on some fronts, risks have been increasing. This is how these processes start; individual marginal transactions that produce a little deterioration, subsequently continue this process of macro deterioration, producing higher risks across the industry as a whole.

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Our principal milestones this year are concentrated in Protecta. Today a comment appeared regarding what is happening in Peru. I just want to mention that the Peruvian Superintendent resigned yesterday. He was incorrect in that the table that he proposed was incorrect, and authorities reacted in that way. What do we expect? Probably changes in mortality rates adjusted accordingly, that's what we thought, and I do not believe that there will be significant change within the industry regarding that.

The second milestone, which is still in process, refers to our interest in Penta Security. In some ways, the process continues, and exclusively depends on authorization by the Superintendency of Securities and Insurance, in order to launch the takeover bid for a period of 30 days. In our view, we have December for the Superintendency of Securities and Insurance to issue its approval. If this were to happen and the takeover bid lasts for 30 days plus notice periods, etc. then this

transaction will take place next year, in terms of actual payment and the corresponding impact on our income statements. This is the most likely outcome. I am not saying that it cannot occur now, but it would be very difficult. We haven't heard any noise on the matter. It has been said that there is a contract that should be signed before December 31 regarding this transaction. However, there is an agreement to extend that mandate and it is being adjusted accordingly.

The third milestone is the agreement with the Penta Group to fully acquire its third-party asset management business, so to speak. This transaction has only been amended to meet legal requirements. We had intended to acquire the two business units before September 30, I am referring to the brokerage and asset management businesses. However, they continue to be managed by Penta software due to a technological problem. But as we could not separate them, due to the Core Banking system used by the Penta group, that transaction was postponed until the first quarter of next year, thus we are planning to conclude all these transactions on the same date. Therefore, we have been cautious with interim "joint" commercial management, to the extent permitted within current regulations, until the acquisition can be concluded in February or March of next year. There has been no deterioration in the value of assets under management since the acquisition was announced. On the contrary, there is a strong sales campaign to incorporate assets that had been withdrawn prior to the announcement, in such a way that we hope that this transaction can be completed at levels very close to our previous assessments, and of course this will impact our income statement next year.

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The next page summarizes the past 5 years, including 2015 through to September. Basically earnings per share, dividend yield and leverage increased in 2013 as a result of the transaction with Cruz del Sur. We have kept our dividend policy as expected, by selling a subsidiary to produce an improvement in leverage. Leverage should diminish over time. Our equity has increased by capitalizing profits. Vida Security and Banco Security share a medium-term vision to increase their equity, which we have achieved at the Bank. We will probably have a similar vision at Vida Security, to allow for planned expansion in Peru. This lower dividend flow impacted the Group's consolidated cash position, but we do not expect to change the historical pattern of the dividend policy, which is why borrowing, leverage, as you see there, has fallen at a slower rate than usual, in order to maintain this dividend policy and capitalize the Bank as a first priority.

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The Group's profits grew by 2.9% compared to September of last year.

The area that has impacted the Group's consolidated income statement is basically the Bank or specifically the Lending Area, including Factoring, and the Insurance Area. Profits have fallen at the Bank (significantly less than the industry, which has been very positive), but we have made some changes to our provisions policy, probably anticipating the poor period that is coming. This has required us to reclassify some portfolios and make higher provisions, which I believe are sufficient for the times to come.

Profit growth at Factoring has been a little slow, basically due to the initial impact of macroeconomic restraint, which is not connected to credit risk at Factoring, but rather related to asset growth. This has resulted in the volume traded in this market being lower than in previous years, which has squeezed the spreads throughout the industry. In our case we have been impacted more by asset growth, than by price decreases. The industry has suffered a significantly greater fall, whereas we have increased our factored receivables and our customer base. However, the impact of the spread has been higher. That is why I expect that consolidated profits for the Factoring industry will be lower this year than last year.

Unemployment has not increased significantly, or at the rate that it could have happened. Therefore, it has not impacted insurance companies to the same extent as the return on their financial investments. Domestic and international returns on equities have performed poorly, which have had a fundamental effect on Vida Security. Prices have performed well. However, premiums at our company have fallen compared to other companies, due to Disability and Survivors Insurance plans not being renewed. This also has an impact on credit, but we have replaced it with other insurance products. You may have noticed that premiums have fallen significantly, which was the right decision with regard to prices, because we believed that as unemployment rose, the claim rate for this scheme would also increase, and therefore rather than add to profits, it would subtract from profits for the industry.

Investments have grown basically due to the consolidation the Cruz del Sur business, which we have already mentioned many times.

Under Other Services, Travel has grown, and there was a transitional deviation compared to previous periods for Real Estate with only an accounting effect. There is an accounting delay in the accrual of profits, so to speak.

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Well, let me begin directly with the Bank. Consolidated profit at the Bank was almost CH\$43,597 million, a fall of 2.7% with respect to the previous year, while the industry fell by 12.5%.

Our gross operating income including subsidiaries grew by almost 12.7% compared to the previous year. This is a very good result when compared to the growth in operating revenue, our core business so to speak, and it deteriorated mainly due to higher provisions.

If you look at the Bank's standalone profits, you will notice that Commercial Banking had lower profits, due to increased provisions for some specific cases, which do not imply overall portfolio deterioration, but rather 2 or 3 cases in the mining and salmon sectors that have hit the industry, and also mining industry suppliers, specifically transport. These three cases hit us a little heavier due to the size of their debts. However, in some cases we had guarantees and we will have to wait for the net result, but our provisions policy does not anticipate the final result.

Therefore, our risk profile remains within that of our peer banks. We have no significant risk deviations with respect to the remainder, and it is concentrated in a few specific cases. There is no deterioration in Commercial Banking, and there is currently no deterioration of credit risk in Retail Banking. Next year we should probably expect a further general deterioration in all portfolios.

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Well, our loans have grown by 12%, and consumer loans by 16%. Unlike the rest of the industry, we restricted our exposure to the mortgage industry, not due to changes in provisions policies, but rather due to profitability. The market has tried to grow this segment as fast as we grew it in previous years. However, we preferred to reduce our growth rate, due to the spreads being offered, and we have focused on our own segment, which requires multiple financing sources for many purposes. This has enabled us to grow consumer lending, as you can see by 16%, versus mortgage lending growth that is significantly lower than the industry.

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Liabilities are still on track. Remember that three or four years ago we chose to slowly change the composition of our time deposits. We are in a process of increasing retail deposits probably over a period of three years, to become 30% of deposits, and decrease institutional deposits to 70%. We started significantly higher, 5 or 6 points higher and we have been declining. I think that this process will continue and bring us a little closer to the larger banks. We are within the range of our peer banks, with no significant deviations.

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We have a vision that our efficiency ratio should be under 50%. We experienced a deviation when we created Retail Banking and reached a peak, I believe it was 57%, and we now want to return to historical levels under 50%. This year and last year we were impacted by extraordinary and volatile profits. We want to stabilize our efficiency ratio at around 44% to 45% or a little higher over the long-term.

We are adjusting revenue, and salaries are our most significant expense, which we have been containing since last year. We are also refining our administrative expenses, which have been impacted by growth in our customer base in recent years, given that all transactional costs and costs associated with debit and credit cards borne by some subsidiaries are included in administrative expenses. But, within a stable process these costs tend to be offset by customer profitability, and we have achieved constant efficiency rates under 50%.

The Bank's equity has grown over the last 3 years (2013, 2014 and 2015). Equity growth has been pure equity growth as defined by the Basel Convention, namely increased retained earnings or share issuances. We suspended placing subordinated bonds in 2013. We hope to continue this policy, so that all equity growth meets this definition. We retained all profits for 2013, and we distributed 30% in 2014. What will happen this year? I believe that we are going to return to

around 30% to 40%, leaving us with the potential to capitalize. Therefore, the sale of Penta Security is going to help us.

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With regard to the market and our peer banks, our gross operating income divided by total assets is at 4.06%, whereas the industry is at 3.76%, and our competitors are at 4.76%. As I mentioned recently, we are fortunate with our efficiency ratio. Our peer banks are at 50.86%. The risk index for our peer banks is 1.68%, while we have 1.70%. There has been a small increase over the last 3 to 4 months which is not significant, as a result of the change to our model for anticipating risks, anticipating portfolio reclassification periods, etc. which has been focused on specific cases within Commercial Banking. So if you look, the commercial risk index at peer banks is 1.67% while we have 1.81%. It is not significantly different, but was impacted as described previously.

Fortunately, return on assets and return on equity have increased recently. Our return on assets was under 1%, though we have recovered sufficiently to achieve more than 1% (1.06%), which has been our historical vision. We have a vision to achieve return on equity of close to 15% as quickly as possible. This year and last year were influenced by these good financial results, but the truth is that we had to build them on the basis of increased productivity, which we have been working on for the past two years. Our Basel I Convention indicators are similar to the industry, and similar to our peer banks.

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The next page describes Commercial Banking and Retail Banking. I believe that Manuel, who is here, can explain these in more detail, since I must leave, but before leaving I would like to touch on the life insurance business, and then return to Manuel for an explanation of the Commercial Bank.

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Our result at Vida has been fundamentally impacted by the return on our investments. Although here we see 4.4% with respect to the industry (4.2% in absolute terms), our return has fallen in comparison to previous years. We have a good return on equity, and our direct premiums have fallen compared to the market. However, we lost the contract for Disability and Survivors Insurance, which we have managed to offset by selling other insurance products. Our net profit has fallen by more than the industry, basically due to the financial issue that I have just mentioned.

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You can see the trends in premium growth. We hope that premiums will grow, compared to the previous year. Administrative expenses have also been contained. You see that there has been practically no growth from September to September. This containment resulted from synergies

achieved during the consolidation process with Cruz del Sur. Profit has fallen by 12.3%, due to lower returns on financial investments.

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The premium composition is displayed here. The Disability and Survivors Insurance that I have just mentioned represented 25% of total premiums last year, this year it represents 0.2%. What does that mean? Basically we have had to increase the individual business, the group business, and in particular the annuity business, which has benefited from changes in regulations. Furthermore, we have significantly increased the sale of annuities at Protecta over the past three months. We hope to be more competitive with other companies over the coming years. That is why we have been making changes to administration at all levels in recent months. In fact 30 days ago we appointed a new CEO, formerly the Commercial Manager at Rimac, the largest Peruvian insurance company. He is now our CEO, and we are also making some human resource changes in various parts of the company at lower levels.

The remaining group companies are within budget. As I said, Factoring has been affected by the spread. I would say that the real estate business is out of phase with regard to achieving budget and its net profit will be similar to last year. However, its synergies with the insurance company are strengthening every day, with our current premium growth and our long-term vision for premiums, such as the sale of annuities. This helps us to increase our share of the real estate market.

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The Asset Management Area refers to the general fund manager (AGF) and brokerage subsidiaries, and their funds under management fell by 0.4%. We have indeed suffered a relatively significant loss in funds under management, and very little from the point of view of profitability. Why is that? We manage a significant amount of resources for an investment fund, and this fund decided to make an adjustment in its portfolio. We thereby lost the management of these resources on their behalf, so losing AUM¹, and we also lost part of the revenue, but this revenue was no more than 25% of what should have been collected. Therefore, the impact on results is lower, but it did impact the figures, suggesting a more widespread deterioration, which is evidently not the case. Rather, it is due to a single event.

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As a result of synergies the AGF carries the greatest weight in profit growth, followed by the brokerage subsidiary, which was affected by the share sale in May of this year. Obviously, the result for Valores² would have been very different without that share sale.

¹ AUM: Assets Under Management.

² Valores Security is the brokerage subsidiary within Grupo Security

This is in general. Manuel had to leave to answer a telephone call, so I would like you to initially ask any questions regarding the insurance company, as Rodrigo and the remaining people are here to help, and when Manuel returns we can continue with the Bank and the points that you need clarified in greater depth. Many thanks for coming and forgive me for having to leave a little early. Many thanks and I leave you with Rodrigo.

Marcela Villafaña, (Head of Investor Relations):

If anyone has any questions regarding the life insurance company, please ask.

Analyst 1

Rodrigo, I had two questions about the life insurance company's results. Firstly, I wanted to understand what happened with the investment result. I understand that you mentioned the mark-to-market for equities. Please can you respond, and I will then ask the second question, to avoid asking too many questions at once.

Rodrigo Guzman

Yes, well, that is correct. The main item that is impacting the investment result is equity investment returns in our own portfolio, and the investment returns on insurance with savings components (CUI). The CUI investment returns have their counterpart in reserves, and thus they free reserves as the portfolio deteriorates its value, so the effect on the bottom line tends to be fairly innocuous. However, our own portfolio performance hits us, and in particular there are international funds, investment funds, mutual funds and shares that represent a low percentage, but have still made an impact. Although, we did recover part of that loss in October, but as we all know, these returns are essentially variable.

Analyst 1

Great. We have seen that premiums are growing this year, with particular growth in annuities. The issue is the vector discount rate that has lower reserve requirements, so this segment can now grow more aggressively. Shall we see this important double digit growth during the remainder of the year?

Rodrigo Guzman

Yes, the premium growth is led by the insurance with savings components (CUI). This insurance has performed very well and commercially has had very good results. There is plenty of premium scope here. However, the premium collected under CUI is usually reflected in reserves, so there is a trade-off that affects the bottom line. Nevertheless in premium terms the CUI insurance has performed very well. Effectively we have taken a smaller accounting loss on the sale of annuities, so we have softened our approach a little. Remember that last year we forecast a sale loss rate of around 10.5%, and it is now around 4%. So we have created a smaller accounting loss, which has

given us room to increase the growth in annuities. Our current annuity sales are around UF 2 million, and will be close to UF 2.3 million by the end the year.

Analyst 1

Great, thank you.

Marcela Villafaña

Do you have any other questions for the insurance company?

Analyst 2

Please can you expand on the potential impact resulting from the higher reserves required by the new mortality tables. La Tercera reported something about this issue two weeks ago, if I am not mistaken, and mentioned that the market should provision around US\$ 600 million. Please can you provide us with a comment.

Rodrigo Guzman

Look, we don't have a lot of information regarding that issue. Particularly because there are many things still being discussed. We all have that same figure, which was calculated on the same basis as all such calculations. There are several points being discussed. For example, whether this will be gradually introduced or not. For example, whether the effect is taken to equity or profit. Therefore, there are too many key variables to produce a serious estimate. I believe the figure that you mentioned is the same figure that is circulating around the market. We still do not have sufficient information regarding how this will be recognized, and whether the effect will be taken directly to equity or charged directly to profits. Neither has the Superintendent clarified the issue.

Analyst 2

Great, and is there a deadline that we should know about, something more specific?

Rodrigo Guzman

We hope that within the next two months we should have more clarity on this issue. As it would be very complicated for us to compile a budget for next year if the authority still leaves us with outstanding points with regard to this issue. But I imagine that as usual, just as last time there was a change in reserves and a change in the standards, even though the market was shaken by grandiose numbers, the final figure was more reasonable and was applied gradually, giving companies the choice of how to implement it. So, I imagine that this case will be similar. I cannot imagine that reserves will take the full hit in one go.

Analyst 2

Great, thank you.

Marcela Villafaña

Is there anything else for the insurance company? If there are no more questions, we turn to questions for the Bank. Anyway, any other questions can be submitted by email or by telephone.

Analyst 1

I have a question regarding the Bank. I refer to what Renato briefly mentioned at the beginning, that 2016 is no longer expected to be as promising as it appeared to be at the beginning of the year. What is the loan strategy at the Bank? What segments do you intend to grow, or reduce?

Manuel Widow (Planning and Management Manager at Banco Security):

Hello, it's Manuel Widow. Over the next few years (2016, 2017, 2018), the Bank is planning to grow at the same rate as the industry, but always focusing on more profitable segments that have enabled us to diversify our revenue sources. Until a short time ago, we were very dependent on Commercial Banking and the Treasury business. Since then medium-sized enterprise banking and retail banking have developed strongly. The plan is to continue in this direction, to strengthen these various revenue sources, to diversify our revenue base using four consolidated banking areas.

Analyst 1

Great. But are you saying the same that you said at the beginning of the year, right? The macro economic slowdown evidenced by specific macro economic parameters has not led to a change in strategy.

Manuel Widow

No, we have not changed our strategy. The orders of magnitude have changed somewhat. Obviously we cannot grow any faster, within an industry that has been slowing down together with the economy. Clearly all segments are probably going to grow a little more slowly than we had expected about a year ago, but more or less with the same composition.

Marcela Villafaña

I would say that we were the most pessimistic bank in the industry in early 2015, in terms of growth and unemployment projections. So nothing much has changed for us. Growth projections for the year have changed across the market.

Manuel Widow

But as we have been the most pessimistic, we fall short.

Marcela Villafaña

Of course we fall short. So there are changes in orders of magnitude.

Analyst 1

Great. Going on to the quarterly results of the Bank for this quarter, the Treasury issue. What happened to Treasury this quarter, as it appeared a little weak, and the Treasury results?

Manuel Widow

The issue is how the two main variables have evolved, inflation on the one hand, and interest rates on the other. During the first semester the expectation lingered that interest rates would continue falling. However, that has already disappeared from the map and the expectation is that they will now rise. Of course, when rates rise all around, banks find it more difficult to earn money from currency mismatches. Meanwhile, inflation for the first half of the year was significantly higher than we are seeing now in the second half. This also affects nearly all banks, clearly some more than others, depending on their positions and mismatches.

Analyst 1

Great, thank you.

Marcela Villafaña

Do you have any other questions regarding the Bank, or any other issue? Well, if there are no more questions let's wrap it up here. You have our email, and we will upload this presentation onto the web site. So I thank you for connecting and we will keep in touch.

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