BANCO SANTANDER CHILE
Form 6-K
April 06, 2018

FORM 6-K

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Report of Foreign Issuer

Pursuant to Rule 13a-16 or 15d-16 of
the Securities Exchange Act of 1934

Commission File Number: 001-14554

Banco Santander Chile
Santander Chile Bank
(Translation of Registrant's Name into English)

Bandera 140
Santiago, Chile
(Address of principal executive office)

Indicate by check mark whether the registrant files or will file annual reports under cover of Form 20-F or Form 40-F:

Form 20-Fx Form 40-F¨

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(1):

Yes¨ Nox

Indicate by check mark if the registrant is submitting the Form 6-K in paper as permitted by Regulation S-T Rule 101(b)(7):

Yes¨ Nox

Indicate by check mark whether by furnishing the information contained in this Form, the Registrant is also thereby furnishing the information to the Commission pursuant to Rule 12g3-2(b) under the Securities Exchange Act of 1934:

Yes¨ Nox

If "Yes" is marked, indicate below the file number assigned to the registrant in connection with Rule 12g3-2(b): N/A

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

BANCO
SANTANDER-CHILE

By: /s/ Cristian Florence
Name: Cristian Florence
Title: General Counsel

Date: April 5, 2018

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CONSOLIDATED STATEMENTS OF FINANCIAL POSITION

		As of December 31,	
		2017	2016
	NOTE	MCh$	MCh$
ASSETS			
Cash and deposits in banks	4	1,452,922	2,279,389
Cash items in process of collection	4	668,145	495,283
Trading investments	5	485,736	396,987
Investments under resale agreements	6	-	6,736
Financial derivative contracts	7	2,238,647	2,500,782
Interbank loans, net	8	162,599	272,635
Loans and accounts receivables from customers, net	9	26,747,542	26,113,485
Available for sale investments	10	2,574,546	3,388,906
Held to maturity investments		-	-
Investments in associates and other companies	11	27,585	23,780
Intangible assets	12	63,219	58,085
Property, plant, and equipment	13	242,547	257,379
Current taxes	14	-	-
Deferred taxes	14	385,608	372,699
Other assets	15	755,183	840,499
TOTAL ASSETS		**35,804,279**	37,006,645
LIABILITIES			
Deposits and other demand liabilities	16	7,768,166	7,539,315
Cash items in process of being cleared	4	486,726	288,473
Obligations under repurchase agreements	6	268,061	212,437
Time deposits and other time liabilities	16	11,913,945	13,151,709
Financial derivative contracts	7	2,139,488	2,292,161
Interbank borrowing	17	1,698,357	1,916,368
Issued debt instruments	18	7,093,653	7,326,372
Other financial liabilities	18	242,030	240,016
Current taxes	14	6,435	29,294
Deferred taxes	14	9,663	7,686
Provisions	20	324,329	308,982
Other liabilities	21	745,363	795,785
TOTAL LIABILITIES		32,696,216	34,108,598
EQUITY			

Attributable to the equity holders of the Bank		3,066,180	2,868,706
Capital	23	891,303	891,303
Reserves	23	1,781,818	1,640,112
Valuation adjustments	23	(2,312)	6,640
Retained earnings		395,371	330,651
Retained earnings from prior years		-	-
Income for the year		564,815	472,351
Minus: Provision for mandatory dividends	23	(169,444)	(141,700)
Non-controlling interest	25	**41,883**	29,341
TOTAL EQUITY		**3,108,063**	2,898,047
TOTAL LIABILITIES AND EQUITY		**35,804,279**	37,006,645

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

Banco Santander Chile and Subsidiaries

CONSOLIDATED STATEMENTS OF INCOME FOR THE YEAR

For the years ended

		As of December 31,	
		2017	2016
	NOTE	MCh$	MCh$
OPERATING INCOME			
Interest income	26	2,058,446	2,137,044
Interest expense	26	(731,755)	(855,678)
Net interest income		1,326,691	1,281,366
Fee and commission income	27	455,558	431,184
Fee and commission expense	27	(176,495)	(176,760)
Net fee and commission income		279,063	254,424
Net income (expense) from financial operations	28	2,796	(367,034)
Net foreign exchange gain	29	126,956	507,392
Other operating income	34	87,163	18,299
Net operating profit before provision for loan losses		1,822,669	1,694,447
Provision for loan losses	30	(299,205)	(343,286)
NET OPERATING PROFIT		1,523,464	1,351,161
Personnel salaries and expenses	31	(396,967)	(395,133)
Administrative expenses	32	(230,103)	(226,413)
Depreciation and amortization	33	(77,823)	(65,359)
Impairment of property, plant, and equipment	33	(5,644)	(234)
Other operating expenses	34	(96,014)	(85,198)
Total operating expenses		(806,551)	(772,337)
OPERATING INCOME		716,913	578,824

Income from investments in associates and other companies	11	3,963	3,012
Income before tax		720,876	581,836
Income tax expense	14	(143,613)	(107,120)
NET INCOME FOR THE YEAR		577,263	474,716
Attributable to:			
Equity holders of the Bank		564,815	472,351
Non-controlling interest	25	12,448	2,365
Earnings per share attributable to Equity holders of the Bank:			
(expressed in Chilean pesos)			
Basic earnings	23	2,997	2,507
Diluted earnings	23	2,997	2,507

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

Banco Santander Chile and Subsidiaries

CONSOLIDATED STATEMENTS OF OTHER COMPREHENSIVE INCOME

For the years ended

	NOTE	As of December 31, 2017 MCh$	2016 MCh$
NET INCOME FOR THE YEAR		577,263	474,716
OTHER COMPREHENSIVE INCOME - ITEMS WHICH MAY BE RECLASSIFIED SUBSEQUENTLY TO PROFIT OR LOSS			
Availablefor sale investments	10	(5,520)	14,468
Cash flow hedge	23	(5,850)	(6,338)
Other comprehensive income which may be reclassified subsequently to profit or loss, before tax		(11,370)	8,130
Income tax related to items which may be reclassified subsequently to profit or loss	14	2,754	(1,975)
Other comprehensive income for the period which may be reclassified subsequently to profit or loss, net of tax		(8,616)	6,155
OTHER COMPREHENSIVE INCOME THAT WILL NOT BE RECASSIFIED SUBSEQUENTLY TO PROFIT OR LOSS		-	-
TOTAL COMPREHENSIVE INCOME FOR THE YEAR		568,647	480,871
Attributable to:			
Equity holders of the Bank		555,863	477,703
Non-controlling interest	25	12,784	3,168

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

Banco Santander Chile and Subsidiaries

CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

For the years ended December 31, 2017 and 2016

		RESERVES		VALUATION ADJUSTMENTS			RETAINED EARNINGS			
	Capital	Reserves and other retained earnings	Effects of merger of companies under common control	Available for sale investments	Cash flow hedge	Income tax effects	Retained earnings of prior years	Income for the year	Provision for mandatory dividends	Total attributable to equity holders of the Bank
	MCh$	MCh$	MCh$	MCh$	MCh$	MCh$	MCh$	MCh$	MCh$	MCh$
Equity as of December 31, 2015	891,303	1,530,117	(2,224)	(6,965)	8,626	(373)	-	448,878	(134,663)	2,734,699
Distribution of income from previous period	-	-	-	-	-	-	448,878	(448,878)	-	-
Equity as of January 1, 2016	891,303	1,530,117	(2,224)	(6,965)	8,626	(373)	448,878	-	(134,663)	2,734,699
Increase or decrease of capital and reserves	-	-	-	-	-	-	-	-	-	-
Dividends distributions/ withdrawals made	-	-	-	-	-	-	(336,659)	-	134,663	(201,996)
Transfer of retained earnings to reserves	-	112,219	-	-	-	-	(112,219)	-	-	-
Provision for mandatory dividends	-	-	-	-	-	-	-	-	(141,700)	(141,700)

Subtotals	-	112,219	-	-	-	-	(448,878)	-	(7,037)	(343,696)
Other comprehensive income	-	-	-	13,414	(6,338)	(1,724)	-	-	-	5,352
Income for the year	-	-	-	-	-	-	-	472,351	-	472,351
Subtotals	-	-	-	13,414	(6,338)	(1,724)	-	472,351	-	477,703
Equity as of December 31, 2016	891,303	1,642,336	(2,224)	6,449	2,288	(2,097)	-	472,351	(141,700)	2,868,706
Equity as of December 31, 2016	891,303	1,642,336	(2,224)	6,449	2,288	(2,097)	-	472,351	(141,700)	2,868,706
Distribution of income from previous period	-	-	-	-	-	-	472,351	(472,351)	-	-
Equity as of January 1, 2017	891,303	1,642,336	(2,224)	6,449	2,288	(2,097)	472,351	-	(141,700)	2,868,706
Increase or decrease of capital and reserves	-	-	-	-	-	-	-	-	-	-
Dividends distributions/ withdrawals made	-	-	-	-	-	-	(330,645)	-	-	(330,645)
Transfer of retained earnings to reserves	-	141,706	-	-	-	-	(141,706)	-	-	-
Provision for mandatory dividends	-	-	-	-	-	-	-	-	(27,744)	(27,744)
Subtotals	-	141,706	-	-	-	-	(472,351)	-	(27,744)	(358,389)
Other comprehensive income	-	-	-	(5,990)	(5,850)	2,888	-	-	-	(8,952)
Income for the year	-	-	-	-	-	-	-	564,815	-	564,815
Subtotals	-	-	-	(5,990)	(5,850)	2,888	-	564,815	-	555,863
Equity as of December 31, 2017	891,303	1,784,042	(2,224)	459	(3,562)	791	-	564,815	(169,444)	3,066,180

Period	Total attributable to equity holders of the Bank	Allocated to reserves	Allocated to dividends	Percentage distributed	Number of shares	Dividend per share (in chilean pesos)
	MCh$	MCh$	MCh$	%		

Year 2016 (Shareholders Meeting April 2017)	472,351	141,706	330,645	70	188,446,126,794	1.755
Year 2015 (Shareholders Meeting April 2016)	448,878	112,219	336,659	75	188,446,126,794	1.787

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

Banco Santander Chile and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended

		As of December 31,	
		2017	2016
	NOTE	MCh$	MCh$
A – CASH FLOWS FROM OPERATING ACTIVITIES:			
NET INCOME FOR THE YEAR		577,263	474,716
Debits (credits) to income that do not represent cash flows		(1,198,140)	(1,079,258)
Depreciation and amortization	33	77,823	65,359
Impairments of property, plant, and equipment	33	5,644	234
Provision for loan losses	30	382,520	421,584
Mark to market of trading investments		1,438	(2,682)
Income from investments in associates and other companies	11	(3,963)	(3,012)
Net gain on sale of assets received in lieu of payment	34	(28,477)	(13,535)
Provision on assets received in lieu of payment	34	3,912	9,246
Net gain on sale of property, plant, and equipment	34	(23,229)	(2,017)
Charge off of assets received in lieu of payment	34	30,027	15,423
Net interest income	26	(1,326,691)	(1,281,366)
Net fee and commission income	27	(279,063)	(254,424)
Other debits (credits) to income that do not represent cash flows		(29,903)	5,112
Changes in deferred taxes	14	8,178	(39,180)
Increase/decrease in operating assets and liabilities		219,661	1,356,832
(Increase) decrease of loans and accounts receivables from customers, net		(629,605)	(1,643,744)
(Increase) decrease of financial investments		725,611	(1,417,211)
Decrease (increase) due to resale agreements (assets)		6,736	(4,273)
Decrease (increase) of interbank loans		110,036	(261,774)
(Increase) decrease of assets received or awarded in lieu of payment		10,243	18,238
Increase (decrease) of debits in customers checking accounts		127,968	268,695
Increase (decrease) of time deposits and other time liabilities		(1,237,764)	968,942
Increase (decrease) of obligations with domestic banks		(364,956)	365,436
Increase (decrease) of other demand liabilities or time obligations		100,883	(85,502)
Increase (decrease) of obligations with foreign banks		146,947	243,355
Increase (decrease) of obligations with Central Bank of Chile		(2)	3
Increase (decrease) of obligations under repurchase agreements		55,624	68,748
Increase (decrease) in other financial liabilities		2,014	19,489
Net increase of other assets and liabilities		(166,361)	263,937

Redemption of letters of credit		(11,772)	(16,606)
Mortgage bond issuances		-	-
Senior bond issuances		911,581	3,537,855
Redemption mortgage bonds and payments of interest		(5,736)	(5,492)
Redemption and maturity of of senior bonds and payments of interest		(1,167,656)	(2,499,271)
Interest received		2,058,446	2,137,044
Interest paid		(731,755)	(855,678)
Dividends received from investments in other companies	11	116	217
Fees and commissions received	27	455,558	431,184
Fees and commissions paid	27	(176,495)	(176,760)
Total cash flow provided by (used in) operating activities		(401,216)	752,290

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

Banco Santander Chile and Subsidiaries

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the years ended

	NOTE	As of December 31, 2017 MCh$	2016 MCh$
B – CASH FLOWS FROM INVESTMENT ACTIVITIES:			
Purchases of property, plant, and equipment	13	(58,771)	(62,356)
Sales of property, plant, and equipment	13	17,940	560
Purchases of investments in associates and other companies	11	(3)	(1,123)
Purchases of intangible assets	12	(32,624)	(27,281)
Total cash flow provided by (used in) investment activities		(73,458)	(90,200)
C – CASH FLOW FROM FINANCING ACTIVITIES:			
From shareholder´s financing activities		(345,544)	(348,787)
Redemption of subordinated bonds and payments of interest		(14,899)	(12,128)
Dividends paid		(330,645)	(336,659)
From non-controlling interest financing activities		(242)	(4,008)
Dividends and/or withdrawals paid		(242)	(4,008)
Total cash flow used in financing activities		(345,786)	(352,795)
D – NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS DURING THE PERIOD		(820,460)	309,295
E – EFFECTS OF FOREIGN EXCHANGE RATE FLUCTUATIONS		(31,398)	(150,266)
F – INITIAL BALANCE OF CASH AND CASH EQUIVALENTS		2,486,199	2,327,170
FINAL BALANCE OF CASH AND CASH EQUIVALENTS	4	1,634,341	2,486,199

Reconciliation of provisions for the Consolidated Statements **of Cash Flows for the periods**		As of December 31, 2017 MCh$	2016 MCh$
Provision for loan losses for cash flow purposes		382,520	421,584
Recovery of loans previously charged off		(83,315)	(78,298)
Provision for loan losses - net	30	299,205	343,286

Reconciliation of liabilities arising from financing activities	December, 31 2016 MCh$	Cash Flow MCh$	Changes other than cash			Fair Value Changes MCh$	December, 31 2017 MCh$
			Acquisition MCh$	Foreign Currency Movement MCh$	UF Movement MCh$		
Subordinated Bonds	759,665	-	-	-	13,527	-	773,192
Dividends paid	-	(330,645)	-	-	-	-	(330,645)
Other	-	-	-	-	-	-	-
Total liabilities from financing activities	759,665	(330,645)	-	-	13,527	-	442,547

The accompanying notes 1 to 39 form an integral part of these consolidated financial statements.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

CORPORATE INFORMATION

Banco Santander Chile is a banking corporation (limited company) operating under the laws of the Republic of Chile, headquartered at Bandera N°140, Santiago. The corporation provides a broad range of general banking services to its customers, ranging from individuals to major corporations. Banco Santander Chile and its subsidiaries (collectively referred to as the “Bank” or “Banco Santander Chile”) offers commercial and consumer banking services, including (but not limited to) factoring, collection, leasing, securities and insurance brokering, mutual and investment fund management, and investment banking.

Banco Santander Spain controls Banco Santander Chile through its holdings in Teatinos Siglo XXI Inversiones Ltda. and Santander Chile Holding S.A., which are controlled subsidiaries of Banco Santander Spain. As of December 31, 2017, Banco Santander Spain owns or controls directly and indirectly 99.5% of Santander Chile Holding S.A. and 100% of Teatinos Siglo XXI Inversiones Ltda. This makes Banco Santander Spain have control over 67.18% of the Bank’s shares.

a) Basis of preparation

These Consolidated Financial Statements have been prepared in accordance with the Compendium of Accounting Standards issued by the Superintendency of Banks and Financial Institutions (SBIF), the Chilean regulatory agency. Article 15 of the General Banking Law states that banks must apply accounting standards established by SBIF. For those issues not covered by the SBIF, the Bank must apply generally accepted standards issued by the Colegio de Contadores de Chile A.G (Association of Chilean Accountants), which conform with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). In the event that any discrepancies exist between IFRS and accounting standards issued by the SBIF (Compendium of Accounting Standards and Instructions), the latter shall prevail.

For purposes of these financial statements the Bank uses certain terms and conventions. References to “US$”, “U.S. dollars” and “dollars” are to United States dollars, references to “EUR” are to European Economic Community Euro, references to “CNY” are to Chinese Yuan, references to “CHF” are to Swiss franc, references to “Chilean pesos”, “pesos” or “Ch$” are to Chilean pesos, and references to “UF” are to Unidades de Fomento. The UF is an inflation-indexed Chilean monetary unit with a value in Chilean pesos that changes daily to reflect changes in the official Consumer Price Index (“CPI”) of the Instituto Nacional de Estadísticas (the Chilean National Institute of Statistics) for the previous month.

The Notes to the Consolidated Financial Statements contain additional information to support the figures submitted in the Consolidated Statement of Financial Position, Consolidated Statement of Income, Consolidated Statement of Comprehensive Income, Consolidated Statement of Changes in Equity and Consolidated Statement of Cash Flows for the period. These contain narrative descriptions and details of these statements in a clear, relevant, reliable and comparable manner.

b) Basis of preparation for the Consolidated Financial Statements

The Consolidated Financial Statements as of December 31, 2017 and 2016 and December 31, 2016 and for the nine-month period ended December 31, 2017 and 2016, incorporate the financial statements of the Bank entities over which the Bank has control (including structured entities); and includes the adjustments, reclassifications and eliminations needed to comply with the accounting and valuation criteria established by IFRS. Control is achieved when the Bank:

I. has power over the investee (i.e., it has rights that grant the current capacity of managing the relevant activities of the investee)
II. is exposed, or has rights, to variable returns from its involvement with the investee; and
III. has the ability to use its power to affect its returns.

The Bank reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Bank has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities over the investee unilaterally. The Bank considers all relevant facts and circumstances in assessing whether or not the Bank’s voting rights in an investee are sufficient to give it power, including:

- The size of the Bank’s holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- The potential voting rights held by the Bank, other vote holders or other parties;
- The rights arising from other agreements; and

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

- any additional facts and circumstances that indicate that the Bank has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Bank obtains control over the subsidiary and ceases when the Bank loses control over the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the Consolidated Statement of Income and in the Consolidated Financial Statementof Comprehensive Income from the date the Bank gains control until the date when the Bank ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income are attributed to the owners of the Bank and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Bank and to the non-controlling interests even if this results in the non-controlling interests having a deficit in certain circumstances.

When necessary, adjustments are made to the financial statements of the subsidiaries to ensure their accounting policies are consistent with the Bank's accounting policies. All balances and transacctions between consolidated entities are eliminated.

Changes in the consolidated entities ownership interests in subsidiaries that do not result in a loss of control over the subsidiaries are accounted for as equity transactions. The carrying values of the Bank's equity and the non-controlling interests' equity are adjusted to reflect the changes to their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognized directly in equity and attributed to owners of the Bank.

In addition, third parties' shares in the Bank's consolidated equity are presented as "Non-controlling interests" in the Consolidated Statement of Changes in Equity. Their share in the income for the year is presented as "Attributable to non-controlling interest" in the Consolidated Statement of Income.

The following companies are considered entities controlled by the Bank and are therefore within the scope of consolidation:

i. Entities controlled by the Bank through participation in equity

			Percent ownership share					
		Place of	**As of December 31,**					
		Incorporation	2017			2016		
Name of the Subsidiary	Main Activity	and operation	Direct %	Indirect %	Total %	Direct %	Indirect %	Total %
Santander Corredora de Seguros Limitada	Insurance brokerage	Santiago, Chile	99.75	0.01	99.76	99.75	0.01	99.76
Santander Corredores de Bolsa Limitada	Financial instruments brokerage	Santiago, Chile	50.59	0.41	51.00	50.59	0.41	51.00
Santander Agente de Valores Limitada	Securities brokerage	Santiago, Chile	99.03	-	99.03	99.03	-	99.03
Santander S.A. Sociedad Securitizadora	Purchase of credits and issuance of debt instruments	Santiago, Chile	99.64	-	99.64	99.64	-	99.64

The details of non-controlling interest in all the subsidiaries can be seen in Note 25 – Non-controlling interest.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

ii. Entities controlled by the Bank through other considerations

The following companies have been consolidated as of December 31, 2017 and 2016 based on the fact that the activities relevant on them are determined by the Bank (companies complementary to the banking sector) and therefore the Bank exercises control:

- Santander Gestión de Recaudación y Cobranza Limitada (collection services)
- Bansa Santander S.A. (management of repossessed assets and leasing of properties)

iii. Associates

An associate is an entity over which the Bank has the ability to exercise significant influence, but not control or joint control. This ability is usually represented by a share equal to or higher than 20% of the voting rights of the Company and is accounted for using the equity method.

The following companies are considered "Associates" in which the Bank accounts for its participation using the equity method:

	Place of Incorporation	Percentage of ownership share As of December 31,

Associates	Main activity	and Operation	2017 %	2016 %
Redbanc S.A.	ATM services	Santiago, Chile	33.43	33.43
Transbank S.A.	Debit and credit card services	Santiago, Chile	25.00	25.00
Centro de Compensación Automatizado S.A.	Electronic fund transfer and compensation services	Santiago, Chile	33.33	33.33
Sociedad Interbancaria de Depósito de Valores S.A.	Repository of publically offered securities	Santiago, Chile	29.29	29.29
Cámara de Compensación de Pagos de Alto Valor S.A.	Payments clearing	Santiago, Chile	15.00	14.23
Administrador Financiero del Transantiago S.A.	Administration of boarding passes to public transportation	Santiago, Chile	20.00	20.00
Sociedad Nexus S.A.	Credit card processor	Santiago, Chile	12.90	12.90
Servicios de Infraestructura de Mercado OTC S.A.	Administration of the infrastructure for the financial market of derivative instruments	Santiago, Chile	12.07	12.07

During the year 2017, the entities Rabobank Chile in Liquidation and Banco París, assigned to Banco Santander a portion of its participation in "Sociedad Operadora de la Cámara de Compensación de pagos de Valores S.A.", with which the Bank's participation increased to 15.00%.

In the case of Nexus S.A. and Compensation Chamber for High-Value Payments S.A., Banco Santander Chile has a representative in the Board of Directors of such companies, which is why the Administration has concluded that it exercises significant influence over the same.

In the case of Market Infrastructure Services OTC S.A. The Bank participates, through its executives, actively in the administration and in the organizational process, which is why the Administration has concluded that it exerts significant influence about it.

During the fourth quarter of 2016, Banco Penta assigned to Banco Santander a portion of its interest in the companies "Sociedad Operadora de la Cámara de Compensación de pagos de Alto Valor S.A." y "Servicios de Infraestructura de Mercado OTC S.A." with which the Bank's participation increased to 14.93% and 12.07% respectively.

During the third quarter of 2016, Deutsche Bank assigned to Banco Santander a portion of its interest in the companies "Sociedad Operadora de la Cámara de Compensación de pago de Alto Valor S.A." and "Servicios de Infraestructura de Mercado OTC S.A." with which the Bank's participation increased in that opportunity

to 14.84% and 11.93% respectively.

At the Extraordinary Shareholders' Meeting of Transbank S.A. held on April 21, 2016, it was agreed to increase capital of the company through the capitalization of retained earnings, through the issue of paid-up shares, and placement of payment actions for approximately $ 4,000 million. Banco Santander Chile participated proportionally to its participation (25%), for which it subscribed and paid shares for approximately $ 1,000 million.

Banco Santander Chile and Subsidiaries

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

iv. Share or rights in other companies

Entities over which the Bank has no control or significant influences are presented in this category. These holdings are shown at acquisition value (historical cost) less impairment, if any.

c) Non-controlling interest

Non-controlling interest represents the portion of gains or losses and net assets which the Bank does not own, either directly or indirectly. It is presented separately in the Consolidated Statement of Income, and separately from shareholders' equity in the Consolidated Statement of Financial Position.

In the case of entities controlled by the Bank through other considerations, income and equity are presented in full as non-controlling interest, since the Bank controls them, but does not have any ownership.

d) Reporting segments

Operating segments with similar economic characteristics often exhibit similar long-term financial performance. Two or more segments can be combined only if aggregation is consistent with International Financial Reporting Standard 8 "Operating Segments" (IFRS 8) and the segments have similar economic characteristics and are similar in each of the following respects:

i. the nature of the products and services;
ii. the nature of the production processes;
iii. the type or class of customers that use their products and services;
iv. the methods used to distribute their products or services; and
v. if applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

The Bank reports separately on each operating segment that exceeds any of the following quantitative thresholds:

i. its reported revenue, from both external customers and intersegment sales or transfers, is 10% or more of the combined internal and external revenue of all the operating segments.

ii. the absolute amount of its reported profit or loss is equal to or greater than 10% : (i) the combined reported profit of all the operating segments that did not report a loss; (ii) the combined reported loss of all the operating segments that reported a loss.

iii. its assets represent 10% or more of the combined assets of all the operating segments.

Operating segments that do not meet any of the quantitative threshold may be treated as segments to be reported, in which case the information must be disclosed separately if management believes it could be useful for the users of the Consolidated Financial Statements.

Information about other business activities of the segments not separately reported is combined and disclosed in the “Other segments” category.

According to the information presented, the Bank’s segments were selected based on an operating segment being a component of an entity that:

i. engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses from transactions with other components of the same entity);
ii. whose operating results are regularly reviewed by the entity’s chief executive officer, who makes decisions about resources allocated to the segment and assess its performance; and
iii. for which discrete financial information is available.

e) Functional and presentation currency

The Bank, in accordance with IAS 21 "Effects of Variations in Exchange Rates of the Foreign Currency", has defined as functional and presentation currency the Chilean Peso, which is the currency of the primary economic environment in which the Bank operates, it also obeys the currency that influences the structure of costs and revenues. Therefore, all balances and transactions denominated in currencies other than the Chilean Peso are considered as "Foreign currency".

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

f) Foreign currency transactions

The Bank performs transactions in foreign currencies, mainly the U.S. dollar. Assets and liabilities denominated in foreign currencies and held by the Bank are translated to Chilean pesos based on the representative market rate published by Reuters at 1:30 p.m. on the month end date. The rate used was Ch$616.85 per US$1 for December, 2017 (Ch$666.00 per US$1 for December, 2016).

The amount of net foreign exchange gains and losses include recognition of the effects that exchange rate variations have on assets and liabilities denominated in foreign currencies and the profits and losses on foreign exchange spot and forward transactions undertaken by the Bank.

g) Definitions and classification of financial instruments

i. Definitions

A “financial instrument” is any contract that gives rise to a financial asset of an entity, and a financial liability or equity instrument of another entity.

An “equity instrument” is a legal transaction that evidences a residual interest on the assets of an entity deducting all of its liabilities.

A “financial derivative” is a financial instrument whose value changes in response to changes with regard to an observed market variable (such as an interest rate, a foreign exchange rate, a financial instrument’s price, or a market index, including credit ratings), whose initial investment is very small compared with other financial instruments having a similar response to changes in market factors, and which is generally settled at a future date.

“Hybrid financial instruments” are contracts that simultaneously include a non-derivative host contract together with a financial derivative, known as an embedded derivative, which is not separately transferable and has the effect that some of the cash flows of the hybrid contract vary in a way similar to a stand-alone derivative. In the first semester of 2017 and during 2016, Banco Santander did not keep implicit derivatives in its portfolio.

ii. Classification of financial assets for measurement purposes

Financial assets are classified into the following specified categories: financial assets trading investments at fair value through profit or loss (FVTPL), ‘held to maturity investments’, ‘available for sale investments’ (AFS) financial assets and ‘loans and accounts receivable from customers'. The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. Regular way purchases or sales of financial assets require delivery of the asset within the time frame established by regulation or convention in the marketplace.

Financial assets are initially recognized at fair value plus, in the case of financial assets that aren’t accounted for at fair value with changes in profit or loss, transaction costs that are directly attributable to the acquisition or issue.

Effective interest method

The effective interest method is a method of calculating the amortised cost of a debt instrument and of allocating interest income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees and points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Income is recognised on an effective interest basis for loans and accounts receivables other than those financial assets classified at fair value through profit or loss.

Financial assets FVTPL - Trading investments

Financial assets are classified as FVTPL when the financial asset is either held for trading or it is designated as fair value through profit or loss.

A financial asset is classified as held for trading if:

- it has been acquired with the purpose of selling it in the short term; or
- on initial recognition it is part of a portfolio of identified financial instruments that the Bank manages together and has a recent actual pattern of short-term profit-taking; or
- it is a derivative that is not designated and effective as a hedging instrument

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SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

A financial asset other than a financial asset held for trading may be designated as FVTPL upon initial recognition if:

- such designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise; or
- the financial asset forms part of a group of financial assets or financial liabilities or both, which is managed and its performance is evaluated on a fair value basis, in accordance with the Bank's documented risk management or investment strategy, and information about the grouping is provided internally on that basis; or
- it forms part of a contract containing one or more embedded derivatives, and IAS 39 permits the entire combined contract to be designated as FVTPL.

Financial assets FVTPL are stated at fair value, with any gains or losses arising on remeasurement recognised in profit or loss. The net gain or loss recognised incorporates any dividend or interest earned on the financial asset and is included in the ‘net income (expense) from financial operations' line item.

Held to maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Bank has the positive intent and ability to hold to maturity. Subsequent to initial recognition, held-to-maturity investments are measured at amortised cost using the effective interest method less impairment.

Available for sale investments (AFS investments)

AFS investments are non-derivatives that are either designated as AFS or are not classified as (a) loans and accounts receivable from customers, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss (trading investments).

Financial instruments held by the Bank that are traded in an active market are classified as AFS and are stated at fair value at the end of each reporting period. The Bank also has investments in financial instruments that are not traded in an active market but that are also classified as AFS investments and stated at fair value at the end of each reporting period (because the directors consider that fair value can be reliably measured). Changes in the carrying amount of AFS monetary financial assets relating to changes in foreign currency rates, interest income calculated using the effective interest method and dividends on AFS equity investments are recognised in profit or loss. Other changes in the carrying amount of available for sale investments are recognised in other comprehensive income and accumulated under the heading of "Valuation Adjustment". When the investment is disposed of or is determined to be impaired, the cumulative gain or loss previously accumulated in the investments revaluation reserve is reclassified to profit or loss.

Dividends on AFS equity instruments are recognised in profit or loss when the Bank's right to receive the dividends is established.

The fair value of AFS monetary financial assets denominated in a foreign currency is determined in that foreign currency and translated as the described in f) above. The foreign exchange gains and losses that are recognised in profit or loss are determined based on the amortised cost of the monetary asset.

Loans and accounts receivables from customers

Loans and accounts receivable from customers are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and accounts receivables from customers (including loans and accounts receivable from customers and interbank loans) are measured at amortised cost using the effective interest method, less any impairment.

Interest income is recognised by applying the effective interest rate, except for short-term receivables where discounting effects are immaterial.

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

iii. Classification of financial assets for presentation purposes

For presentation purposes, the financial assets are classified by their nature into the following line items in the Consolidated Financial Statements:

- Cash and deposits in banks: this line includes cash balances, checking accounts and on-demand deposits with the Central Bank of Chile and other domestic and foreign financial institutions. Amounts invested as overnight deposits are included in this item and in the corresponding items. If a special item for these operations is not mentioned, they will be included along with the accounts being reported.

- Cash items in process of collection: this item includes values of documents in process of transfer and balances from operations that, as agreed, are not settled the same day, and purchase of currencies not yet received.

- Trading investments: this item includes financial instruments held-for-trading and investments in mutual funds which must be adjusted to their fair value.

- Financial derivative contracts: financial derivative contracts with positive fair values are presented in this item. It includes both independent contracts as well as derivatives that should and can be separated from a host contract, whether they are for trading or accounted for as derivatives held for hedging, as shown in Note 6.

  . Trading derivatives: includes the fair value of derivatives which do not qualify for hedge accounting, including embedded derivatives separated from hybrid financial instruments.

- Hedging derivatives: includes the fair value of derivatives designated as being in a hedging relationship, including the embedded derivatives separated from the hybrid financial instruments.

- Interbank loans: this item includes the balances of transactions with domestic and foreign banks, including the Central Bank of Chile, other than those reflected in certain other financial asset classifications listed above.

- Loans and accounts receivables from customers: these loans are non-derivative financial assets for which fixed or determined amounts are charged, that are not listed on an active market and which the Bank does not intend to sell immediately or in the short term. When the Bank is the lessor in a lease, and it substantially transfers the risks and rewards incidental to the leased asset, the transaction is presented in loans and accounts receivable from customers while the leased asset is removed from the Bank´s financial statements.

- Investment instruments: are classified into two categories: held-to-maturity investments, and available-for-sale investments. The held-to-maturity investment classification includes only those instruments for which the Bank has the ability and intent to hold to maturity. The remaining investments are treated as available for sale.

iv. Classification of financial liabilities for measurement purposes

Financial liabilities are classified as either financial liabilities FVTPL or other financial liabilities:

Financial liabilities FVTPL

As of December 31, 2017 and 2016, the Bank does not have financial liabilities with changes in results.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Other financial liabilities

Other financial liabilities (including loans and accounts payable) are subsequently measured at amortised cost using the effective interest method.

v. Classification of financial liabilities for presentation purposes

Financial liabilities are classified by their nature into the following items in the Consolidated Statement of Financial Position:

- Deposits and other on-demand liabilities: this includes all on-demand obligations except for term savings accounts, which are not considered on-demand instruments in view of their special characteristics. Obligations whose payment may be required during the period are deemed to be on-demand obligations. Operations which become callable the day after the closing date are not treated as on-demand obligations.

- Cash items in process of collection: this item includes balances from asset purchase operations that are not settled the same day, and sale of currencies not yet delivered.

- Obligations under repurchase agreements: this includes the balances of sales of financial instruments under securities repurchase and loan agreements. The Bank does not record as own portfolio instruments acquired under repurchase agreements.

- Time deposits and other time liabilities: this shows the balances of deposit transactions in which a term at the end of which they become callable has been stipulated.

- Financial derivative contracts: this includes financial derivative contracts with negative fair values (i.e. a liability of the Bank), whether they are for trading or for hedge accounting, as set forth in Note 6.

- Trading derivatives: includes the fair value of derivatives which do not qualify for hedge accounting, including embedded derivatives separated from hybrid financial instruments.

- Hedging derivatives: includes the fair value of derivatives designated as being in a hedging relationship, including the embedded derivatives separated from the hybrid financial instruments.

- Interbank borrowings: this includes obligations due to other domestic banks, foreign banks, or the Central Bank of Chile, other than those reflected in certain other financial liability classifications listed above.

- Issued debt instruments: there are three types of instruments issued by the Bank: obligations under letters of credit, subordinated bonds and senior bonds placed in the local and foreign market.

- Other financial liabilities: this item includes credit obligations to persons other than domestic banks, foreign banks, or the Central Bank of Chile, for financing purposes or operations in the normal course of business.

Banco Santander Chile and Subsidiaries

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

h) Valuation of financial instruments and recognition of fair value changes

Generally, financial assets and liabilities are initially recognized at fair value, which, in the absence of evidence against it, is deemed to be the transaction price. Financial instruments, other than those measured at fair value through profit or loss, are initially recognized at fair value plus transaction costs. Subsequently, and at the end of each reporting period, financial instruments are measured with the following criteria:

i. Valuation of financial instruments

Financial assets are measured according to their fair value, gross of any transaction costs that may be incurred in the course of a sale, except for credit investments and held to maturity investments.

According to IFRS 13 *Fair Value Measurement*, “fair value” is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (i.e. an exit price) regardless of whether that price is directly observable or estimated using another valuation technique. When measuring fair value an entity shall take into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date.

The fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either: (a) in the principal market for the asset or liability, or (b) in the absence of a principal market, the most advantageous market for the asset or liability. Even when there is no observable market to provide pricing information in connection with the sale of an asset or the transfer of a liability at the measurement date, the fair value measurement shall assume that the transaction takes place, considered from the perspective of a potential market participant who intends to maximize value associated with the asset or liability.

When using valuation techniques, the Bank shall maximize the use of relevant observable inputs and minimize the use of unobservable inputs as available. If an asset or a liability measured at fair value has a bid price and an ask price, the price within the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value regardless of where the input is categorized within the fair value hierarchy (i.e. Level 1, 2 or 3). IFRS 13 establishes a fair value hierarchy that categorizes into three levels the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs).

Every derivative is recorded in the Consolidated Statements of Financial Position at fair value as previously described. This value is compared to the valuation at the trade date. If the fair value is subsequently measured positive, this is recorded as an asset, if the fair value is subsequently measured negative, this is recorded as a liability. The fair value on the trade date is deemed, in the absence of evidence to the contrary, to be the transaction price. The changes in the fair value of derivatives from the trade date are recorded in “Net income (expense) from financial operations” in the Consolidated Statement of Income.

Specifically, the fair value of financial derivatives included in the portfolios of financial assets or liabilities held for trading is deemed to be their daily quoted price. If, for exceptional reasons, the quoted price cannot be determined on a given date, the fair value is determined using similar methods to those used to measure over the counter (OTC) derivatives. The fair value of OTC derivatives is the sum of the future cash flows resulting from the instrument, discounted to present value at the date of valuation (“present value” or “theoretical close”) using valuation techniques commonly used by the financial markets: “net present value” (NPV) and option pricing models, among other methods. Also, within the fair value of derivatives are included Credit Valuation Adjustment (CVA) and Debit Valuation Adjustment (DVA), all with the objective that the fair value of each instrument includes the credit risk of its counterparty and Bank´s own risk. Counterparty Credit Risk (CVA) is a valuation adjustment to derivatives contracted in non-organized markets as a result of exposure to counterparty credit risk. The CVA is calculated considering the potential exposure to each counterparty in future periods. Own-credit risk (DVA) is a valuation adjustment similar to the CVA, but generated by the Bank's credit risk assumed by our counterparties. As of December 31, 2017, the CVA and DVA are Ch $ 8,142 million and Ch $ 15,406 million, respectively.

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

“Loans and accounts receivable from customers” and Held-to-maturity instrument portfolio are measured at amortized cost using the effective interest method. Amortized cost is the acquisition cost of a financial asset or liability, plus or minus, as appropriate, prepayments of principal and the cumulative amortization (recorded in the consolidated income statement) of the difference between the initial cost and the maturity amount as calculated under the effective interest method. For financial assets, amortized cost also includes any reductions for impairment or uncollectibility. For loans and accounts receivable designated as hedged items in fair value hedges, the changes in their fair value related to the risk or risks being hedged are recorded in “Net income (expense) from financial operations”.

The “effective interest rate” is the discount rate that exactly matches the initial amount of a financial instrument to all its estimated cash flows over its remaining life. For fixed-rate financial instruments, the effective interest rate incorporates the contractual interest rate established on the acquisition date. Where applicable, the fees and transaction costs that are a part of the financial return are included. For floating-rate financial instruments, the effective interest rate matches the current rate of return until the date of the next review of interest rates.

The amounts at which the financial assets are recorded represent the Bank’s maximum exposure to credit risk as at the reporting date. The Bank has also received collateral and other credit enhancements to mitigate its exposure to credit risk, which consist mainly of mortgage guarantees, equity instruments and personal securities, assets under leasing agreements, assets acquired under repurchase agreements, securities loans and derivatives.

ii. Valuation techniques

Financial instruments at fair value, determined on the basis of price quotations in active markets, include government debt securities, private sector debt securities, equity shares, short positions, and fixed-income securities issued.

In cases where price quotations cannot be observed in available markets, the Bank's management determines a best estimate of the price that the market would set using its own internal models. In most cases, these models use data based on observable market parameters as significant inputs however for some valuations of financial instruments, significant inputs are unobservable in the market. To determine a value for those instruments, various techniques are employed to make these estimates, including the extrapolation of observable market data.

The most reliable evidence of the fair value of a financial instrument on initial recognition usually is the transaction price, however due to lack of availability of market information, the value of the instrument may be derived from other market transactions performed with the same or similar instruments or may be measured by using a valuation technique in which the variables used include only observable market data, mainly interest rates.

The main techniques used as of September 30, 2017 and 2016 and as of December 31, 2016 by the Bank's internal models to determine the fair value of the financial instruments are as follows:

i. In the valuation of financial instruments permitting static hedging (mainly forwards and swaps), the present value method is used. Estimated future cash flows are discounted using the interest rate curves of the related currencies. The interest rate curves are generally observable market data.

ii. In the valuation of financial instruments requiring dynamic hedging (mainly structured options and other structured instruments), the Black-Scholes model is normally used. Where appropriate, observable market inputs are used to obtain factors such as the bid-offer spread, exchange rates, volatility, correlation indexes and market liquidity.

iii. In the valuation of certain financial instruments exposed to interest rate risk, such as interest rate futures, caps and floors, the present value method (futures) and the Black-Scholes model (plain vanilla options) are used. The main inputs used in these models are observable market data, including the related interest rate curves, volatilities, correlations and exchange rates.

The fair value of the financial instruments calculated by the aforementioned internal models considers contractual terms and observable market data, which include interest rates, credit risk, exchange rates, quoted market price of shares and raw materials, volatility, prepayments and liquidity. The Bank's management considers that its valuation models are not significantly subjective, since these methodologies can be adjusted and evaluated, as appropriate, through the internal calculation of fair value and the subsequent comparison with the related actively traded price.

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

iii. Hedging transactions

The Bank uses financial derivatives for the following purposes:

i. to sell to customers who request these instruments in the management of their market and credit risks;
ii. to use these derivatives in the management of the risks of the Bank entities' own positions and assets and liabilities ("hedging derivatives"), and
iii. to obtain profits from changes in the price of these derivatives (trading derivatives).

All financial derivatives that are not held for hedging purposes are accounted for as trading derivatives.

A derivative qualifies for hedge accounting if all the following conditions are met:

1. The derivative hedges one of the following three types of exposure:

a. Changes in the value of assets and liabilities due to fluctuations, among others, in inflation (UF), the interest rate and/or exchange rate to which the position or balance to be hedged is subject ("fair value hedge");

b. Changes in the estimated cash flows arising from financial assets and liabilities, commitments and highly probable forecasted transactions ("cash flow hedge");

c. The net investment in a foreign operation (“hedge of a net investment in a foreign operation”).

2. It is effective in offsetting exposure inherent in the hedged item or position throughout the expected term of the hedge, which means that:

a. At the date of arrangement the hedge is expected, under normal conditions, to be highly effective (“prospective effectiveness”).

b. There is sufficient evidence that the hedge was actually effective during the life of the hedged item or position (“retrospective effectiveness”).

3. There must be adequate documentation evidencing the specific designation of the financial derivative to hedge certain balances or transactions and how this effective hedge was expected to be achieved and measured, provided that this is consistent with the Bank’s management of own risks.

The changes in the value of financial instruments qualifying for hedge accounting are recorded as follows:

a. For fair value hedges, the gains or losses arising on both hedging instruments and the hedged items (attributable to the type of risk being hedged) are included as “Net income (expense) from financial operations” in the Consolidated Statement of Income.

b. For fair value hedges of interest rate risk on a portfolio of financial instruments, gains or losses that arise in measuring hedging instruments and other gains or losses due to changes in fair value of the underlying hedged item (attributable to the hedged risk) are recorded in the Consolidated Financial Statement of Income under “Net income (expense) from financial operations”.

c. For cash flow hedges, the change in fair value of the hedging instrument is included as “Cash flow hedge” in “Other comprehensive income”, until the hedged transaction occurs, thereafter being reclassified to the Consolidated Statement of Income, unless the hedged transaction results in the recognition of non–financial assets or liabilities, in which case it is included in the cost of the non-financial asset or liability.

d. The differences in valuation of the hedging instrument corresponding to the ineffective portion of the cash flow hedging transactions are recorded directly in the Consolidated Statement of Income under “Net income (expense) from financial operations”.

If a derivative designated as a hedging instrument no longer meets the requirements described above due to expiration, ineffectiveness or for any other reason, hedge accounting treatment is discontinued. When “fair value hedging” is discontinued, the fair value adjustments to the carrying amount of the hedged item arising from the hedged risk are amortized to gain or loss from that date, when applicable.

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SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

When cash flow hedges are discontinued, any cumulative gain or loss of the hedging instrument recognized under "Other comprehensive income" (from the period when the hedge was effective) remains recorded in equity until the hedged transaction occurs, at which time it is recorded in the Consolidated Statement of Income, unless the transaction is no longer expected to occur, in which case any cumulative gain or loss is recorded immediately in the Consolidated Statement of Income.

iv. Derivatives embedded in hybrid financial instruments

Derivatives embedded in other financial instruments or in other host contracts are accounted for separately as derivatives if 1) their risks and characteristics are not closely related to the host contracts, 2) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and 3) provided that the host contracts are not classified as "Trading investments" or as other financial assets (liabilities) at fair value through profit or loss.

v. Offsetting of financial instruments

Financial asset and liability balances are offset, i.e., reported in the Consolidated Statements of Financial Position at their net amount, only if there is a legally enforceable right to offset the recorded amounts and the Bank intends either to settle them on a net basis or to realize the asset and settle the liability simultaneously.

vi. Derecognition of financial assets and liabilities

The accounting treatment of transfers of financial assets is determined by the extent and the manner in which the risks and rewards associated with the transferred assets are transferred to third parties:

i. If the Bank transfers substantially all the risks and rewards of ownership to third parties, as in the case of unconditional sales of financial assets, sales under repurchase agreements at fair value at the date of repurchase, sales of financial assets with a purchased call option or written put option deeply out of the money, utilization of assets in which the transferor does not retain subordinated debt nor grants any credit enhancement to the new holders, and other similar cases, the transferred financial asset is derecognized from the Consolidated Statement of Financial Position and any rights or obligations retained or created in the transfer are simultaneously recorded.

ii. If the Bank retains substantially all the risks and rewards of ownership associated with the transferred financial asset, as in the case of sales of financial assets under repurchase agreements at a fixed price or at the sale price plus interest, securities lending agreements under which the borrower undertakes to return the same or similar assets, and other similar cases, the transferred financial asset is not derecognized from the Consolidated Financial Statement of Financial Position and continues to be measured by the same criteria as those used before the transfer. However, the following items are recorded:

- An associated financial liability for an amount equal to the consideration received; this liability is subsequently measured at amortized cost.
- Both the income from the transferred (but not removed) financial asset as well as any expenses incurred due to the new financial liability.

iii. If the Bank neither transfers nor substantially retains all the risks and rewards of ownership associated with the transferred financial asset—as in the case of sales of financial assets with a purchased call option or written put option that is not deeply in or out of the money, securitization of assets in which the transferor retains a subordinated debt or other type of credit enhancement for a portion of the transferred asset, and other similar cases, the following distinction is made:

a. If the transferor does not retain control of the transferred financial asset: the asset is derecognized from the Consolidated Statement of Financial Position and any rights or obligations retained or created in the transfer are recognized.

b. If the transferor retains control of the transferred financial asset: it continues to be recognized in the Consolidated Statement of Financial Position for an amount equal to its exposure to changes in value and a financial liability associated with the transferred financial asset is recorded. The net carrying amount of the transferred asset and the associated liability is the amortized cost of the rights and obligations retained, if the transferred asset is measured at amortized cost, or the fair value of the rights and obligations retained, if the transferred asset is measured at fair value.

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Accordingly, financial assets are only derecognized from the Consolidated Statement of Financial Position when the rights over the cash flows they generate have terminated or when all the inherent risks and rewards of ownership have been substantially transferred to third parties. Similarly, financial liabilities are only derecognized from the Consolidated Financial Statement Financial Position when the obligations specified in the contract are discharged or cancelled or the contract has matured.

i) Recognizing income and expenses

The most significant criteria used by the Bank to recognize its revenues and expenses are summarized as follows:

i. Interest revenue, interest expense, and similar items

Interest revenue, expense and similar items are recorded on an accrual basis using the effective interest method.

However, when a given operation or transaction is past due by 90 days or more, when it originated from a refinancing or renegotiation, or when the Bank believes that the debtor poses a high risk of default, the interest and adjustments pertaining to these transactions are not recorded directly in the Consolidated Statement of Income unless they have been actually received.

This interest and adjustments are generally referred to as “suspended” and are recorded in they are reported as part of the complementary information thereto and as memorandum accounts (Note 23). This interest is recognized as income, when collected.

The resumption of interest income recognition of previously impaired loans only occurs when such loans become current (i.e. payments were received such that the loans are contractually past-due for less than 90 days) or they are no longer classified under the C3, C4, C5, or C6 risk categories (for loans individually evaluated for impairment).

ii. Commissions, fees, and similar items

Fee and commission income and expenses are recognized in the Consolidated Statement of Income using criteria that vary according to their nature. The main criteria are:

(1) Fee and commission income and expenses on financial assets and liabilities measured at fair value through profit or loss are recognized when they are earned or paid.

- Those arising from transactions or services that are performed over a period of time are recognized over the life of these transactions or services.

(2) Those relating to services provided in a single transaction are recognized when the single transaction is performed.

iii. Non-financial income and expenses

Non-financial income and expenses are recognized for accounting purposes on an accrual basis.

j) Impairment

i. Financial assets:

A financial asset, other than that at fair value through profit and loss, is evaluated on each financial statement filing date to determine whether objective evidence of impairment exists.

A financial asset or group of financial assets will be impaired if, and only if, objective evidence of impairment exists as a result of one or more events that occurred after initial recognition of the asset (“event causing the loss”), and this event or events causing the loss have an impact on the estimated future cash flows of a financial asset or group of financial assets.

An impairment loss relating to financial assets recorded at amortized cost is calculated as the difference between the recorded amount of the asset and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate.

Banco Santander Chile and Subsidiaries

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Individually significant financial assets are individually tested to determine their impairment. The remaining financial assets are evaluated collectively in groups that share similar credit risk characteristics.

All impairment losses are recorded in income. Any impairment loss relating to a financial asset available for sale previously recorded in equity is transferred to profit or loss.

The reversal of an impairment loss occurs only if it can be objectively related to an event occurring after the initial impairment loss was recorded. The reversal of an impairment loss shall not exceed the carrying amount that would have been determined if no impairment loss has been recognized for the asset in prior years. The reversal is recorded in income with the exception of available for sale equity financial assets, in which case it is recorded in other comprehensive income.

ii. Non-financial assets:

The Bank's non-financial assets, excluding investment properties, are reviewed at the reporting date to determine whether they show signs of impairment (i.e. its carrying amount exceeds its recoverable amount). If any such evidence exists, the recoverable amount of the asset is estimated, in order to determine the extent of the impairment loss.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognized immediately in profit or loss.

In connection with other assets, impairment losses recorded in prior periods are assessed at each reporting date to determine whether the loss has decreased and should be reversed. The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years. Losses for goodwill impairment recognized through capital gains are not reversed.

k) Property, plant, and equipment

This category includes the amount of buildings, land, furniture, vehicles, computer hardware and other fixed assets owned by the consolidated entities or acquired under finance leases. Assets are classified according to their use as follows:

i. Property, plant and equipment for own use

Property, plant and equipment for own use includes but is not limited to tangible assets received by the consolidated entities in full or partial satisfaction of financial assets representing accounts receivable from third parties which are intended to be held for continuing own use and tangible assets acquired under finance leases. These assets are presented at acquisition cost less the related accumulated depreciation and, if applicable, any impairment losses resulting from comparing the net value of each item to the respective recoverable amount.

Depreciation is calculated using the straight line method over the acquisition cost of assets less their residual value, assuming that the land on which buildings and other structures stand has an indefinite life and, therefore, is not subject to depreciation.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

The Bank applies the following useful lives for the tangible assets that comprise its assets:

ITEM	**Useful life (in months)**
Land	-
Paintings and works of art	-
Carpets and curtains	36
Computers and hardware	36
Vehicles	36
IT systems and software	36
ATMs	60
Other machines and equipment	60
Office furniture	60
Telephone and communication systems	60
Security systems	60
Rights over telephone lines	60
Air conditioning systems	84
Other installations	120
Buildings	1,200

The consolidated entities assess at each reporting date whether there is any indication that the carrying amount of any tangible asset exceeds its recoverable amount. If this is the case, the carrying amount of the asset is reduced to its recoverable amount and future depreciation charges are adjusted in accordance with the revised carrying amount and to the new remaining useful life.

The estimated useful lives of the items of property, plant and equipment held for own use are reviewed at the end of each reporting period to detect significant changes. If changes are detected, the useful lives of the assets are adjusted by correcting the depreciation charge to be recorded in the Consolidated Statement of Income in future years on the basis of the new useful lives.

Maintenance expenses relating to tangible assets held for own use are recorded as an expense in the period in which they are incurred.

ii. Assets leased out under operating leases

The criteria used to record the acquisition cost of assets leased out under operating leases, to calculate their depreciation and their respective estimated useful lives, and to record their impairment losses, are the same as those for property, plant and equipment held for own use.

l) Leasing

i. Finance leases

Finance leases are leases that substantially transfer all the risks and rewards incidental to ownership of the leased asset to the lessee.

When a consolidated entity is the lessor of an asset, the sum of the present value of the lease payments receivable from the lessee, including the exercise price of the lessee's purchase option at the end of the lease term, which is equivalent to one additional lease payment and so is reasonably certain to be exercised, is recognized as lending to third parties and is therefore included under "Loans and accounts receivable from customers" in the Consolidated Statement of Financial Position.

When a consolidated entity is a lessee, it reports the cost of leased assets in the Consolidated Statement of Financial Position based on the nature of the leased asset, and simultaneously records a liability for the same amount (which is the lower of the fair value of the leased asset, and the sum of the present value of the lease payments payable to the lessor plus, if appropriate, the exercise price of the purchase option). The depreciation policy for these assets is the same as that for property, plant and equipment for own use.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

In both cases, the finance income and finance expenses arising from these contracts are credited and debited, respectively, to “Interest income” and “Interest expense” in the Consolidated Statement of Income so as to achieve a constant rate of return over the lease term.

ii. Operating leases

In operating leases, ownership of the leased asset and substantially all the risks and rewards incidental thereto remain with the lessor.

When a consolidated entity is the lessor, it reports the acquisition cost of the leased assets under "Property, plant and equipment”. The depreciation policy for these assets is the same as that for similar items of property, plant and equipment held for own use and revenues from operating leases is recorded on a straight line basis under “Other operating income” in the Consolidated Statement of Income.

When a consolidated entity is the lessee, the lease expenses, including any incentives granted by the lessor, are charged on a straight line basis to “Other operating expenses” in the Consolidated Statement of Income.

iii. Sale and leaseback transactions

For sale at fair value and operating leasebacks, the profit or loss generated is recorded at the time of sale. In the case of finance leasebacks, the profit or loss generated is amortized over the lease term.

m) Factored receivables

Factored receivables are valued at the amount disbursed by the Bank in exchange of invoices or other commercial instruments representing the credit which the transferor assigns to the Bank. The price difference between the amounts disbursed and the actual face value of the credits is recorded as interest income in the Consolidated Statement of Income using the effective interest method over the financing period.

When the assignment of these instruments involves no liability on the part of the assignee, the Bank assumes the risks of insolvency of the parties responsible for payment.

n) Intangible assets

Intangible assets are identified as non-monetary assets (separately identifiable from other assets) without physical substance which arise as a result of legal or contractual rights. The Bank recognizes an intangible asset, whether purchased or self-created (at cost), when the cost of the asset can be measured reliably and it is probable that the future economic benefits that are attributable to the asset will flow to the Bank.

Intangible assets are recorded initially at acquisition or production cost and are subsequently measured at cost less any accumulated amortization and any accumulated impairment losses.

Internally developed computer software is recorded as an intangible asset if, among other requirements (basically the Bank’s ability to use or sell it), it can be identified and its ability to generate future economic benefits can be demonstrated. The estimated useful life for software is 3 years.

Intangible assets are amortized on a straight-line basis over their estimated useful life; which has been defined as 36 months.

Expenditure on research activities is recorded as an expense in the year in which it is incurred and cannot be subsequently capitalized.

o) Cash and cash equivalents

The indirect method is used to prepare the cash flow statement, starting with the Bank's consolidated pre-tax income and incorporating non-cash transactions, as well as income and expenses associated with cash flows, which are classified as investing or financing activities.

The cash flow statement was prepared considering the following definitions:

i. Cash flows: Inflows and outflows of cash and cash equivalents, such as deposits with the Central Bank of Chile, deposits in domestic banks, and deposits in foreign banks.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

ii. Operating activities: Principal revenue-producing activities performed by banks and other activities that cannot be classified as investing or financing activities.

iii. Investing activities: The acquisition and disposal of long-term assets and other investments not included in cash and cash equivalents.

iv. Financing Activities: Activities that result in changes in the size and composition of equity and liabilities that are not operating or investing activities.

p) Allowances for loan losses

The Bank continuously evaluates the entire loan portfolio and contingent loans, as it is established by the SBIF, to timely provide the necessary and sufficient provisions to cover expected losses associated with the characteristics of the debtors and their loans, which determine payment behavior and recovery.

The Bank has established allowances to cover probable losses on loans and account receivables in accordance with instructions issued by Superintendency of Banks and Financial Institutions (SBIF) and models of credit risk rating and assessment approved by the Board’s Committee, including the amendments introduced by Circular No. 3,573 (and its further modifications) applicable as of January 1, 2016 which establishes a standard method for residential mortgage loans and complements and specifies instructions on provisions and loans classified in the impaired portfolio, and subsequent amendments.

The Bank uses the following models established by the SBIF, to evaluate its loan portfolio and credit risk:

- Individual assessment - where the Bank assesses a debtor as individually significant when their loans are significant, or when the debtor cannot be classified within a group of financial assets with similar credit risk characteristics, due to its size, complexity or level of exposure.

- Group assessment - a group assessment is relevant for analyzing a large number of transactions with small individual balances due from individuals or small companies. The Bank groups debtors with similar credit risk characteristics giving to each group a default probability and recovery rate based on a historical analysis. The Bank has implemented standard models for mortgage loans, established in Circular N°3,573 (modified by Circular N°3,584), and internal models for commercial and consumer loans.

I. Allowances for individual assessment

An individual assessment of commercial debtors is necessary according to the SBIF, in the case of companies which, due to their size, complexity or level of exposure, must be known and analyzed in detail.

The analysis of the debtor is primarily focused on their credit quality and their risk category classification of the debtor and of their respective contingent loans and loans These are assigned to one of the following portfolio categories: Normal, Substandard and Impaired. The risk factors considered are: industry or economic sector, owners or managers, financial situation and payment ability, and payment behavior.

The portfolio categories and their definitions are as follows:

i. Normal Portfolio includes debtors with a payment ability that allows them to meet their obligations and commitments. Evaluations of the current economic and financial environment do not indicate that this will change. The classifications assigned to this portfolio are categories from A1 to A6.

ii. Substandard Portfolio includes debtors with financial difficulties or a significant deterioration of their payment ability. There is reasonable doubt concerning the future reimbursement of the capital and interest within the contractual terms, with limited ability to meet short-term financial obligations. The classifications assigned to this portfolio are categories from B1 to B4.

iii. Impaired Portfolio includes debtors and their loans where repayment is considered remote, with a reduced or no likelihood of repayment. This portfolio includes debtors who have stopped paying their loans or that indicate that they will stop paying, as well as those who require forced debt restructuration, reducing the obligation or delaying the term of the capital or interest, and any other debtor who is over 90 days overdue in his payment of interest or capital. The classifications assigned to this portfolio are categories from C1 to C6.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Normal and Substandard Compliance Portfolio

As part of individual assessment, the Bank classifies debtors into the following categories, assigning them a probability of non-performance (PNP) and severity (SEV), which result in the expected loss percentages.

Portfolio	Debtor's Category	Probability of Non-Performance (%)	Severity (%)	Expected Loss (%)
Normal portfolio	A1	0.04	90.0	0.03600
	A2	0.10	82.5	0.08250
	A3	0.25	87.5	0.21875
	A4	2.00	87.5	1.75000
	A5	4.75	90.0	4.27500
	A6	10.00	90.0	9.00000
Substandard portfolio	B1	15.00	92.5	13.87500
	B2	22.00	92.5	20.35000
	B3	33.00	97.5	32.17500
	B4	45.00	97.5	43.87500

The Bank first determines all credit exposures, which includes the accounting balances of loans and accounts receivable from customers plus contingent loans, less any amount recovered through executing the financial guarantees or collateral covering the operations. The percentages of expected loss are applied to this exposure. In the case of collateral, the Bank must demonstrate that the value assigned reasonably reflects the value obtainable on disposal of the assets or equity instruments. When the credit risk of the debtor is substituted for the credit quality of the collateral or guarantor, this methodology is applicable only when the guarantor or surety is an entity qualified in a assimilable investment grade by a local or international company rating agency recognized by the SBIF. Guaranteed securities cannot be deducted from the exposure amount, only financial guarantees and collateral can be considered.

Notwithstanding the foregoing, the Bank must maintain a minimum provision of 0.5% over loans and contingent loans in the normal portfolio.

Impaired Portfolio

The impaired portfolio includes all loans and the entire value of contingent loans of the debtors that are over 90 days overdue on the payment of interest or principal of any loan at the end of the month. It also includes debtors who have been granted a loan to refinance loans over 60 days overdue, as well as debtors who have undergone forced restructuration or partial debt condonation.

The impaired portfolio excludes: a) residential mortgage loans, with payments less than 90 days overdue; and, b) loans to finance higher education according to Law 20,027, provided the breach conditions outlined in Circular No. 3,454 of December 10, 2008 are not fulfilled.

The provision for an impaired portfolio is calculated by determining the expected loss rate for the exposure, adjusting for amounts recoverable through available financial guarantees and deducting the present value of recoveries made through collection services after the related expenses.

Once the expected loss range is determined, the related provision percentage is applied over the exposure amount, which includes loans and contingent loans related to the debtor.

Banco Santander Chile and Subsidiaries

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

The allowance rates applied over the calculated exposure are as follows:

Classification	Estimated range of loss	Allowance	
C1	Up to 3%	2	%
C2	Greater than 3% and less than 20%	10	%
C3	Greater than 20% and less than 30%	25	%
C4	Greater than 30% and less than 50%	40	%
C5	Greater than 50% and less than 80%	65	%
C6	Greater than 80%	90	%

Loans are maintained in the impaired portfolio until their payment ability is normal, notwithstanding the write off of each particular credit that meets conditions of Title II of Chapter B-2. Once the circumstances that led to classification in the Impaired Portfolio have been overcome, the debtor can be removed from this portfolio once all the following conditions are met:

i. the debtor has no obligations of the debtor with the Bank more than 30 days overdue;
ii. the debtor has not been granted loans to pay its obligations;
iii. at least one of the payments include the amortization of capital;
iv. if the debtor has made partial loan payments in the last six months, two payments have already been made;
v. if the debtor must pay monthly installments for one or more loans, four consecutive installments have been made;
vi. the debtor does not appear to have bad debts in the information provided by the SBIF, except for insignificant amounts.

II. Allowances for group assessments

Group assessments are used to estimate allowances required for loans with low balances related to individuals or small companies.

Group assessments require the formation of groups of loans with similar characteristics by type of debtor and loan conditions, in order to establish both the group payment behavior and the recoveries of their defaulted loans, using technically substantiated estimates and prudential criteria. The model used is based on the characteristics of the debtor, payment history, outstanding loans and default among other relevant factors.

The Bank uses methodologies to establish credit risk, based on internal models to estimate the allowances for the group-evaluated portfolio. This portfolio includes commercial loans with debtors that are not assessed individually, mortgage and consumer loans (including installment loans, credit cards and overdraft lines). These methods allow the Bank to independently identify the portfolio behavior and establish the provision required to cover losses arising during the year.

The customers are classified according to their internal and external characteristics into profiles, using a customer-portfolio model to differentiate each portfolio's risk in an appropriate manner. This is known as the profile allocation method.

The profile allocation method is based on a statistical construction model that establishes a relationship through logistic regression between variables (for example default, payment behavior outside the Bank, socio-demographic data) and a response variable which determines the client's risk, which in this case is over 90 days overdue. Hence, common profiles are established and assigned a Probability of Non-Performance (PNP) and a recovery rate based on a historical analysis known as Severity (SEV).

Therefore, once the customers have been profiled, and the loan's profile assigned a PNP and a SEV, the exposure at default (EXP) is calculated. This exposure includes the book value of the loans and accounts receivable from the customer, plus contingent loans, less any amount that can be recovered by executing guarantees (for credits other than consumer loans).

Notwithstanding the above, on establishing provisions associated with housing loans, the Bank must recognize minimum provisions according to standard methods established by the SBIF for this type of loan. While this is considered to be a prudent minimum base, it does not relieve the Bank of its responsibility to have its own methodologies of determining adequate provisions to protect the credit risk of the portfolio.

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Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Standard method of residential mortgage loan provisions

As of January 1, 2016 and in accordance with Circular No. 3,573 issued by the SBIF, the Bank began applying the standard method of provisions for residential mortgage loans. According to this method, the expected loss factor applicable to residential mortgage loans will depend on the default of each loan and the relationship between the outstanding principal of each loan and the value of the associated mortgage guarantee (Loans to Value, LTV) at the end of each month.

The allowance rates applied according to default and LTV are the following:

LTV Range	Days overdue at month end	**0**	**1-29**	**30-59**	**60-89**	Impaired portfolio
	PNP(%)	1.0916	21.3407	46.0536	75.1614	100
LTV≤40%	Severity (%)	0.0225	0.0441	0.0482	0.0482	0.0537
	Expected Loss (%)	0.0002	0.0094	0.0222	0.0362	0.0537
	PNP(%)	1.9158	27.4332	52.0824	78.9511	100
40%< LTV ≤80%	Severity (%)	2.1955	2.8233	2.9192	2.9192	3.0413
	Expected Loss (%)	0.0421	0.7745	1.5204	2.3047	3.0413
	PNP(%)	2.5150	27.9300	52.5800	79.6952	100
80%< LTV ≤90%	Severity (%)	21.5527	21.6600	21.9200	22.1331	22.2310
	Expected Loss (%)	0.5421	6.0496	11.5255	17.6390	22.2310
	PNP(%)	2.7400	28.4300	53.0800	80.3677	100
LTV >90%	Severity (%)	27.2000	29.0300	29.5900	30.1558	30.2436
	Expected Loss (%)	0.7453	8.2532	15.7064	24.2355	30.2436

LTV =Loan capital/Value of guarantee

If the same debtor has more than one residential mortgage loan with the Bank and one of them over 90 days overdue, all their loans shall be allocated to the impaired portfolio, calculating provisions for each them in accordance with their respective LTV.

For residential mortgage loans related to housing programs and grants from the Chilean government, the allowance rate may be weighted by a factor of loss mitigation (LM), which depends on the LTV percentage and the price of the property in the deed of sale (S), as long as the debtor has contracted auction insurance provided by the Chilean government.

III. Additional provisions

According to SBIF regulation, banks are allowed to establish provisions over the limits already described, to protect themselves from the risk of non-predictable economical fluctuations that could affect the macro-economic environment or a specific economic sector.

According to No. 10 of Chapter B-1 from the SBIF Compendium of Accounting Standards, these provisions will be recorded in liabilities, similar to provisions for contingent loans.

IV. Charge-offs

As a general rule, charge-offs should be done when the contract rights over cash flow expire. In the case of loans, even if the above does not happen, the Bank will charge-off these amounts in accordance with Title II of Chapter B-2 of the Compendium of Accounting Standards (SBIF).

These charge-offs refer to the derecognition from the Consolidated Statements of Financial Position of the respective loan, including any not yet due future payments in the case of installment loans or leasing transactions (for which partial charge-offs do not exist).

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Charge-offs are always recorded as a charge to loan risk allowances according to Chapter B-1 of the Compendium of Accounting Regulations, no matter the reason for the charge-off. Any payment received related to a loan previously charged-off will be recognized as recovery of loan previously charged-off at the Consolidated Statement of Income.

Loan and accounts receivable charge-offs are recorded for overdue, past due, and current installments when they exceed the time periods described below since reaching overdue status:

Type of loan	Term
Consumer loans with or without collateral	6 months
Other transactions without collateral	24 months
Commercial loans with collateral	36 months
Mortgage loans	48 months
Consumer leasing	6 months
Other non-mortgage leasing transactions	12 months
Mortgage leasing (household and business)	36 months

V. Recovery of loans previously charged off and accounts receivable from customers

Any recovery on “Loans and accounts receivable from customers” previously charged-off will be recognized as a reduction in the credit risk provisons in the Consolidated Statement of Income.

Any renegotiation of a loan previously charged-off will not give rise to income, as long as the operation continues being considered as impaired. The cash payments received must be treated as recoveries of charged-off loans.

The renegotiated loan can only be included again in assets if it is no longer considered as impaired, also recognizing the capitalization income as recovery of charged-off loans.

q) Provisions, contingent assets, and contingent liabilities

Provisions are liabilities of uncertain timing or amount. Provisions are recognized in the Consolidated Statements of Financial Position when the Bank:

i. has a present obligation (legal or constructive) as a result of past events, and
ii. it is probable that an outflow of resources will be required to settle these obligations and the amount of these resources can be reliably measured.

Contingent assets or contingent liabilities are any potential rights or obligations arising from past events whose existence will be confirmed only by the occurrence or non-occurrence if one or more uncertain future events that are not wholly within control of the Bank.

The Consolidated Financial Statements reflect all significant provisions for which it is estimated that the probability of having to meet the obligation is more than likely than not. Provisions are quantified using the best available information regarding the consequences of the event giving rise to them and are reviewed and adjusted at the end of accounting period. Provisions are used when the liabilities for which they were originally recognized are settled. Partial or total reversals are recognized when such liabilities cease to exist or are reduced.

Provisions are classified according to the obligation covered as follows:

- Provision for employee salaries and expenses
- Provision for mandatory dividends
- Provision for contingent loan risks
- Provisions for contingencies

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

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NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

r) Income taxes and deferred taxes

The Bank records, when appropriate, deferred tax assets and liabilities for the estimated future tax effects attributable to differences between the carrying amount of assets and liabilities and their tax bases. The measurement of deferred tax assets and liabilities is based on the tax rate, in accordance with the applicable tax laws, using the tax rate that applies to the period when the deferred asset and liability will be recovered or settled. The future effects of changes in tax legislation or tax rates are recorded in deferred taxes from the date on which the law is enacted or substantially enacted.

s) Use of estimates

The preparation of the financial statements requires the Bank's management to make estimates and assumptions that affect the application of the accounting policies and the reported values of assets, liabilities, revenues and expenses. Actual results may differ from these estimates.

In certain cases, International Financial Reporting Standards (IFRS) require that assets or liabilities be recorded or disclosed at their fair values. The fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between informed market participants at the measurement date. When available, quoted market prices in active markets have been used as the basis for measurement. When quoted market prices in active markets are not available, the Bank has estimated such values based on the best information available, including the use of internal modeling and other valuation techniques.

The Bank has established allowances to cover cover probable losses, to estimate allowances. These allowances must be regularly reviewed taking into consideration factors such as changes in the nature and volume of the loan portfolio, trends in forecasted portfolio quality, credit quality and economic conditions that may adversely affect the borrowers' ability to pay. Increases in the allowances for loan losses are reflected as "Provision for loan losses" in the Consolidated Statement of Income.

Loans are charged-off when the contractual rights for the cash flows expire, however, for loans and accounts receivable from customers the bank will charge-off in accordance with Title II of Chapter B-2 of the Compendium of Accounting Standards issued by the SBIF. Charge-offs are recorded as a reduction of the allowance for loan losses.

The relevant estimates and assumptions made to calculate provisions are regularly reviewed by the Bank's Management to quantify certain assets, liabilities, revenues, expenses, and commitments.

Revised accounting estimates are recorded in the period in which the estimate is revised and in any affected future period.

These estimates are based on the best available information and mainly refer to:

- Allowances for loan losses (Notes 8, 9, and 30)
- Impairment losses of certain assets (Notes 7, 8, 9, 10, and 33)
- The useful lives of tangible and intangible assets (Notes 12, 13 and 33)
- The fair value of assets and liabilities (Notes 5, 6, 7, 10 and 37)
- Commitments and contingencies (Note 22)
- Current and deferred taxes (Note 14)

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Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

t) Non-current assets held for sale

Non-current assets (or a group of assets and liabilities) that expect to be recovered mainly through the sale of these items rather than through their continued use, are classified as held for sale. Immediately prior to this classification, assets (or elements of a disposable group) are valued in accordance with the Bank's policies. The assets (or disposal group) are subsequently valued at the lower of carrying amount and fair value less selling costs.

Assets received or awarded in lieu of payment

Assets received or awarded in lieu of payment of loans and accounts receivable from clients are recognized at their fair value. A price is agreed upon by the parties through negotiation or, when the parties do not reach an agreement, at the amount at which the Bank is awarded those assets at a judicial auction. In the both cases, an independent appraisal is performed.

Any excess of the outstanding loan balance over the fair value is recognized in the Consolidated Statement of Income under "Provision for loan losses".

These assets are subsequently valued at the lower of the amount initially recorded and the net realizable value, which corresponds to its fair value (liquidity value determined through an independent appraisal) less their respective costs of sale. The difference between both are recognized in the Consolidated Statement under "Other operating expenses".

At the end of each year the Bank performs an analysis to review the "selling costs" of assets received or awarded in lieu of payments which will be applied at this date and during the following year. As of December 31, 2017 the average selling cost has been estimated at 3.4% of the appraisal value (5.1% for December 31, 2016).

Independent appraisals are obtained at least every 18 months and fair values are adjusted accordingly.

In general, it is estimated that these assets will be disposed of within a term of one year from its date of award. As set forth in article 84 of the General Banking Act, those assets that are not sold within that term are charged-off in a single installment.

u) Earnings per share

Basic earnings per share are calculated by dividing the net income attributable to the equity holders of the Bank by the weighted average number of shares outstanding during the reported period.

Diluted earnings per share are calculated in a similar manner to basic earnings, but the weighted average number of outstanding shares is adjusted to take into consideration the potential diluting effect of stock options, warrants, and convertible debt.

As of December 31, 2017 and 2016, the Bank did not have any instruments that generated dilution.

v) Temporary acquisition (assignment) of assets and liabilities

Purchases or sales of financial assets under non-optional repurchase agreements at a fixed price (repos) are recorded in the Consolidated Statements of Financial Position as an financial assignment based on the nature of the debtor (creditor) under "Deposits in the Central Bank of Chile," "Deposits in financial institutions" or "Loans and accounts receivable from customers" ("Central Bank of Chile deposits," "Deposits from financial institutions" or "Customer deposits").

Differences between the purchase and sale prices are recorded as financial interest over the term of the contract.

w) Assets under management and investment funds managed by the Bank

Assets owned by third parties and managed by certain companies that are within the Bank’s scope of consolidation (Santander S.A. Sociedad Securitizadora), are not included in the Consolidated Statement of Financial Position. Management fees are included in “Fee and commission income” in the Consolidated Statement of Income.

x) Provision for mandatory dividends

As of December 31, 2017 and 2016, the Bank recorded a provision for minimum mandatory dividends. This provision is made pursuant to Article 79 of the Corporations Act, which is in accordance with the Bank’s internal policy, which requires at least 30% of net income for the period is distributed, except in the case of a contrary resolution adopted at the respective shareholders’ meeting by unanimous vote of the outstanding shares. This provision is recorded as a deduction from “Retained earnings” – “Provision for mandatory dividends” in the Consolidated Statement of Changes in Equity with offset to Provisions.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

y) Employee benefits

i. Post-employment benefits – Defined Benefit Plan:

According to current collective labor agreements and other agreements, the Bank has an additional benefit available to its principal executives, consisting of a pension plan, whose purpose is to endow them with funds for a better supplementary pension upon their retirement.

Features of the Plan:

The main features of the Post-Employment Benefits Plan promoted by the Banco Santander Chile are:

I. Aimed at the Bank's management.
II. The general requirement is that the beneficiary must still be employed by the Bank when reaching 60 years old.
III. The Bank will mixed collective life and savings insurance policy for each beneficiary in the plan. Regular voluntary installments will be paid into this fund by the beneficiary and matched by the Bank.
IV. The Bank will be responsible for granting the benefits directly.

The projected unit credit method is used to calculate the present value of the defined benefit obligation and the current service cost.

Components of defined benefit cost include:

- current service cost and any past service cost, which are recognized in profit or loss for the period;
- net interest on the liability (asset) for net defined benefit, which is recognized in profit or loss for the period;
- new liability (asset) remeasurements for net defined benefit include:

(a) actuarial gains and losses;

(b) the performance of plan assets, and;

(c) changes in the effect of the asset ceiling which are recognized in other comprehensive income.

The liability (asset) for net defined benefit is the deficit or surplus, calculated as the difference between the present value of the defined benefit obligation less the fair value of plan assets.

Plan assets comprise the pension fund taken out by the Group with a third party that is not a related party. These assets are held by an entity legally separated from the Bank and exist solely to pay benefits to employees.

The Bank recognizes the present service cost and the net interest of the Personnel wages and expenses on the Consolidated Statement of Income. Given the plan's structure, it does not generate actuarial gains or losses. The plan's performance is established and fices during the period; consequently, there are no changes in the asset's cap. Accordingly, there are no amounts recognized in other comprehensive income.

The post-employment benefits liability, recognized in the Consolidated Statement of Financial Position, represents the deficit or surplus in the defined benefit plans of the Bank. Any surplus resulting from the calculation is limited to the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions.

When employees leave the plan before meeting the requirements to be eligible for the benefit, contributions made by the Bank are reduced.

ii. Severance provision:

Severance provision for years of employment are recorded only when they actually occur or upon the availability of a formal and detailed plan in which the fundamental modifications to be made are identified, provided that such plan has already started to be implemented or its principal features have been publicly announced, or objective facts about its execution are known.

iii. Cash-settled share based compensation

The Bank allocates cash-settled share based compensation to executives of the Bank and its Subsidiaries in accordance with IFRS 2. The Bank measures the services received and the obligation incurred at fair value.

Until the obligation is settled, the Bank calculates the fair value at the end of each reporting period, as well as at the date of settlement, recognizing any change in fair value in the income statement for the period.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

z) New accounting pronouncements

i. Adoption of new accounting standards and instructions issued both by the Superintendency of Banks and Financial Institutions and the International Accounting Standards Board

As of the issue date of these Consolidated Financial Statements, the following new accounting pronouncements have been issued by the both the SBIF and the IASB, which have been fully incorporated by the Bank and are detailed as follows:

1. Accounting Standards Issued by the SBIF

Circular No. 3,621. Compendium of Accounting Standards. Chapters B-1 and C-3. Credits guaranteed by the School Infrastructure Guarantee Fund. Complementary instructions - This circular issued on March 15, 2017 introduces the following modifications:

• The title of No. 4 of Chapter B-1 is replaced by the following: "4 Warranty, goods delivered under lease, factoring operations and School Infrastructure Guarantee fund".

• The section 4.4 "Guarantee Fund for School Infrastructure" is added to this section, for purposes of determining provisions applicable to the substitution of credit risk of direct credit for the credibility of the referred fund, assigning for this purpose category A1 .

• The following item is added: 1302.1.50 Credits for school infrastructure Law N° 20.845.

This rule is immediately applicable. *This change had no impact on the Bank.*

Circular No. 3,615. Compendium of Accounting Standards. Chapter C-2. Report on the review of financial information - The circular issued on December 12, 2016, aims to increase the level of transparency of the Financial information provided by the banks. Therefore, the SBIF has considered it pertinent that as from June 2017, the financial statements referred to June 30 will be subject to a review report of the financial information issued by its external auditors. In accordance with NAGA No. 63, AU930, or its international equivalent, SAS No. 122, Section AU-C 930, which must be sent to the SBIF on the same day of its publication, or the immediately preceding or following bank business day.

If a bank does not have the necessary information to prepare financial statements with its respective notes within the period established in the law, it shall at least publish and send to the SBIF the Statement of Financial Position and Income Statement, adding a note with the date In which they will be available, although they must be available within the first fortnight of the following month.

In the case of the financial statements referred to as of June 30, the banks must send, by August 15, the review report of their external auditors. *A review of the required regulations has been carried out, including the respective conclusion on the consolidated intermediate financial statements reported to the SBIF.*

2. Accounting Standards issued by the International Accounting Standards Board

Amendment to IAS 12 Recognition of deferred tax assets related to unrealized losses - On January 19, 2016, the IASB issued this amendment to clarify the recognition of deferred assets related to debt instruments measured at fair value due to different recognition practices Of deferred assets, it is clarified that:

- Unrealized losses on debt instruments measured at fair value and measures at cost for tax purposes generate a deductible temporary difference regardless of whether the holder of the debt instrument expects to recover the book value of the debt instrument by sale or use.

- The book value of an asset does not limit the estimate of probable taxable profits.

- The estimate of future taxable income excludes tax deductions from the reverse of deductible temporary differences.

This regulation is applicable as of January 1, 2017. *This change had no impact for the Bank.*

Amendment to IAS 7 Statement of Cash Flow. Disclosure Initiative - This amendment issued on January 29, 2016 improves the information provided to users of the financial statements related to the entities' financing activities. The purpose of the amendment is to provide disclosures that enable users of the financial statements to assess changes in liabilities generated from financing operations. One way to comply with this new disclosure is to provide a reconciliation between the initial and final balance in the EFE for liabilities generated from financing activities.

This regulation is applicable from January 1, 2017, with early application allowed. *The implementation of this amendment had no material impact on the Bank's consolidated financial statements.*

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Annual improvements, cycle 2014-2016

Amendment to IFRS 12 Disclosures of Interest in Other Entities - Clarifies the scope of the standard by specifying that the disclosure requirements of the standard, except for paragraphs B10-B16, apply to interest on an entity listed in paragraph 5 (subsidiaries, joint ventures, associates and non-consolidated structured entities) that are classified as held for sale, held for distribution or as discontinued operations in accordance with IFRS 5 Non-current assets held for sale and discontinued operations.

The amendment to IFRS 12 is for annual periods beginning on or after 1 January 2017. *The implementation of this amendment had no material impact on the Bank's consolidated financial statements.*

ii. New accounting standards and instructions issued by both the Superintendency of Banks and Financial Institutions and by the International Accounting Standards Board that have not come into effect as of December 31, 2017

As of the closing date of these financial statements, new International Financial Reporting Standards had been published as well as interpretations of them and SBIF rules, which were not mandatory as of September 30, 2017. Although in some cases the application Is permitted by the IASB, the Bank has not made its application on that date.

1. Accounting Standards issued by the Superintendency of Banks and Financial Institutions

As of December 31, 2017, there are no new Accounting Standards issued by the Superintendency of Banks and Financial Institutions.

2. Accounting Standards issued by the International Accounting Standards Board

IFRS 9, Financial Instruments - On November 12, 2009, the International Accounting Standards Board (IASB) issued IFRS 9, Financial Instruments. This Standard introduces new requirements for the classification and measurement of financial assets. IFRS 9 specifies how an entity should classify and measure its financial assets. Requires that all financial assets are classified in their entirety on the basis of the entity's business model for the management of financial assets and the characteristics of the contractual cash flows of financial assets.

On October 28, 2010, the IASB published a revised version of IFRS 9, Financial Instruments. The revised Standard retains the requirements for the classification and measurement of financial assets that was published in November 2009, but adds guidelines on the classification and measurement of financial liabilities. Likewise, it has replicated the guidelines on the recognition of financial instruments and the implementation guides related from IAS 39 to IFRS 9. These new guidelines conclude the first phase of the IASB project to replace IAS 39. The other phases, impairment and hedge accounting, have not yet been finalized.

The guidance included in IFRS 9 on the classification and measurement of financial assets has not changed from those established in IAS 39. In other words, financial liabilities will continue to be measured either at amortized cost or at fair value with changes in results. The concept of bifurcation of derivatives incorporated in a contract for a financial asset has not changed Financial liabilities held for trading will continue to be measured at fair value with changes in results, and all other financial assets will be measured at amortized cost unless the value option is applied reasonable using the criteria currently in IAS 39.

Notwithstanding the foregoing, there are two differences with respect to IAS 39:

- The presentation of the effects of changes in fair value attributable to the credit risk of a liability; and

- The elimination of the cost exemption for liabilities derivatives to be settled through the delivery of non-traded equity instruments.

On December 16, 2011, the IASB issued Mandatory Application Date of IFRS 9 and Disclosures of the Transition, deferring the effective date of both the 2009 and 2010 versions to annual periods beginning on or after January 1, 2015 . Prior to the amendments, the application of IFRS 9 was mandatory for annual periods beginning on or after 2013. The amendments change the requirements for the transition from IAS 39 Financial Instruments: Recognition and Measurement to IFRS 9. In addition, they also modify IFRS 7 Financial Instruments: Disclosures to add certain requirements in the reporting period in which the date of application of IFRS 9 is included. Finally, on July 24, 2014, it is established that the date Effective application of this rule will be for annual periods beginning on January 1, 2018.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

On November 19, 2013 ASB issued "Amendment to IFRS 9: hedge accounting and amendments to IFRS 9, IFRS 7 and IAS 39", which includes a new general hedge accounting model, which is more closely aligned with risk management, providing more useful information to the users of the financial statements. On the other hand, the requirements relating to the fair value option for financial liabilities were changed to address the credit risk itself, this improvement establishes that the effects of changes in the credit risk of a liability should not affect the result of the period a unless the liabilities remain to negotiate; the early adoption of this modification is permitted without the application of the other requirements of IFRS 9. In addition, it conditions the effective date of entry into force upon completion of the IFRS 9 project, allowing its adoption in the same way.

On July 24, 2014, the IASB published the final version of IFRS 9 - Financial Instruments, including the regulations already issued together with a new expected loss model and minor modifications to the classification and measurement requirements for financial assets, adding a new category of financial instruments: assets at fair value with changes in other comprehensive result for certain debt instruments. It also includes an additional guide on how to apply the business model and testing of contractual cash flow characteristics.

On October 12, 2017, "Amendment to IFRS 9: Characteristics of Anticipated Cancellation with Negative Compensation" was published, which clarifies that according to the current requirements of IFRS 9, the conditions established in Test SPPI are not met if the Bank should make a settlement payment when the client decides to terminate the credit. With the introduction of this modification, in relation to termination rights, it is allowed to measure at amortized cost (or FVOCI) in the case of negative compensation.

This regulation is effective as of January 1, 2018. Early application is allowed. The Administration in accordance with what is established by the Superintendency of Banks and Financial Institutions, will not apply this norm in advance or in the future, as long as the aforementioned Superintendency does not provide it as a mandatory standard for all banks.

IFRS 15, Income from contracts with clients - On May 28, 2014, the IASB published IFRS 15, which aims to establish principles for reporting useful information to users of financial information about the nature, amount, timing and uncertainty of The income and cash flows generated from an entity's contracts with its customers. IFRS 15 eliminates IAS 11 Construction Contracts, IAS 18 Income, IFRIC 13 Loyalty Programs with Customers, IFRIC 15 Real Estate Construction Agreements, IFRIC 18 Transfer of Assets from Customers and SIC 31 Revenue - Exchange of Advertising Services.

This rule is effective as of January 1, 2017, however, the IASB has deferred its entry into force for annual periods beginning on or after January 1, 2018. Advance application is permitted. *Management is evaluating the potential impact of adopting this standard.*

Amendments to IFRS 10 and IAS 28 - Sale and Contribution of assets between an Investor and its associate or joint venture - On September 11, 2014, the IASB published this amendment, which clarifies the scope of the profits and losses recognized in a transaction involving an associate or joint venture, and that it depends on whether the asset sold or contribution constitutes a business. Therefore, IASB concluded that all of the gains or losses must be recognized against loss of control of a business. In addition, gains or losses arising from the sale or contribution of a non-business subsidiary (definition of IFRS 3) to an associate or joint venture must be recognized only to the extent of unrelated interests in the associate or joint venture.

This standard was initially effective as of January 1, 2016, however, on December 17, 2015, the IASB issued "Effective Date of Amendment to IFRS 10 and IAS 28" postponing indefinitely the entry into force of this standard. *The Administration will be waiting for the new validity to evaluate the potential effects of this modification.*

IFRS 16 Leases - On January 13, 2016, the IASB issued this new regulation which replaces IAS 17 Leases, IFRIC 4 Determination of whether an agreement contains a lease, SIC 15 Operating leases - incentives and SIC 27 Evacuation of the essence of Transactions that take the legal form of a lease. The main effects of this rule apply to tenant accounting, mainly because it eliminates the dual accounting model: operational or financial leasing, this means that tenants must recognize "a right to use an asset" and a liability for Lease (the present value of lease futures payments). In the case of the landlord the current practice is maintained - that is, lessors continue to classify leases as financial and operating leases. This regulation is applicable as of January 1, 2019, with early application permitted if IFRS 15 "Customer Contract Revenue" is applied. *The Administration is evaluating the potential impact of the adoption of these regulations.*

Amendment to IFRS 2 Classification and measurement of share-based payment transactions - This amendment issued on 20 June 2016, addresses matters on which there were consultations and which the IASB decided to address, the matters are:

- Accounting of payment transactions based on shares settled in cash that include a condition of performance.

- Classification of payment transactions based on shares with balance compensation features.

- Accounting for changes in payment transactions based on shares from cash settled to liquidated in equity instruments.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

This amendment is applicable as of January 1, 2018 prospectively, with early application allowed. *The Administration is evaluating the potential impact of adopting this regulation.*

Amendment to IFRS 4 Application of IFRS 9 Financial Instruments and IFRS 4 Insurance Contracts - This amendment issued on September 12, 2016 aims to address concerns about the differences between the effective date of IFRS 9 and the next new IFRS 17 insurance contract rule. This amendment provides two options for the issuing entities insurance contracts within the scope of IFRS 4:

- An option that allows entities to reclassify from profit or loss to other comprehensive income, some of the income or expenses derived from the designated financial assets; This is the so-called superposition approach.

- An optional temporary exemption from the application of IFRS 9 for entities whose main activity consists of the issue of contracts within the scope of IFRS 4; This is the so-called deferment approach.

The entity that opts to apply the overlay approach retroactively to the classification of financial assets will do so when IFRS 9 is applied for the first time, while the entity that chooses to apply the deferral approach will do so for annual periods beginning on or after January 1, 2018. *The Administration has evaluated that this rule will not have effects on the Bank's financial statements.*

IFRIC 22 Transactions in foreign currency and consideration received / delivered in advance - This interpretation issued on December 8, 2016, clarifies the accounting for transactions that include the receipt or payment of a anticipated consideration in a foreign currency. The Interpretation covers transactions in foreign currency when an entity recognizes an asset or a non-monetary liability derived from the payment or anticipated receipt of a consideration before that the entity recognizes the related asset, expense or income. Does not apply when an entity measures recognition of the asset, expense or income related to its fair value or to the fair value of the consideration received or paid in a date other than the date of initial recognition of the non-monetary asset or liability. In addition, it is not necessary to apply interpretation to income taxes, insurance contracts or reinsurance contracts.

The date of the transaction, in order to determine the exchange rate, is the date of the initial recognition of the non-monetary asset paid in advance or liabilities for deferred income. If there are several payments or receipts in advance, a date is established of transaction for each payment or receipt. IFRIC 22 is effective for annual reporting periods beginning at from January 1, 2018. Early application is allowed. *The Administration has assessed that this rule will have no effect on the financial statements of the Bank.*

Annual improvements, cycle 2014-2016

Amendment to IFRS 1 First-time Adoption of International Financial Reporting Standards - Eliminates the short-term exemptions contained in paragraphs E3-E7 (transitional provisions of Financial Instruments, Benefit to Employees and Investment Entities) of IFRS 1, and who have fulfilled the intended purpose.

Amendment to IAS 28 Investments in Associates and Joint Ventures - Clarifies that the choice to measure at fair value through profit and loss changes (FVTPL) an investment in an associate or joint venture that belongs to an entity that is a venture capital organization, or other Qualified entity, is available for each investment in an associated entity or joint venture on the basis of the investment, after the initial recognition.

The amendments to IFRS 1 and IAS 28 are effective for annual periods beginning on or after January 1, 2018. *The Administration is evaluating the potential impact of the adoption of this regulation.*

IFRS 17 Insurance contracts - This regulation issued on May 18, 2017, establishes principles for the recognition, measurement, presentation and disclosure of the insurance contracts issued. It also requires similar principles to apply to maintained reinsurance contracts and to investment contracts issued with discretionary participation components. IFRS 17 repeals IFRS 4 Insurance Contracts. IFRS 17 will be applied to annual periods beginning on or after January 1, 2021. Early application is permitted. *This standard does not apply directly to the Bank, however, the Bank has participation in insurance business and ensure that this regulation is applied correctly and timely.*

IFRIC 23 Uncertainty over Income Tax Treatments- This interpretation issued on June 7, 2017 clarifies the accounting for tax uncertainties, which are used to determine income tax, tax basis, tax losses and unused loans, when there is an uncertainty about the treatment necessary by the IAS 12 “Income Taxes”. This rule includes four points: a) If an entity accounts for tax uncertainties individually or as a whole, b) The assumptions that an entity makes about the revisions for the tax treatment established by the tax authority, c) How an entity determines a taxable gain or loss, its tax base, tax losses and unused loans and tax rates, and d) How an entity considers the changes made and their circumstances.

This interpretation will be effective for the annual periods starting on January 1, 2019. The anticipated adoption of this standard is allowed. *Management is assessing the potential impact of the adoption of this standard.*

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 01

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, continued

Practice declarations – Making materiality judgements, this declaration has been issued on September, 2017 and corresponds to a guide with regard to how to make materiality judgements. This practice declaration motivates companies to apply judgement in order to prepare financial statements with information that is useful for the investors more than trying to abide with a checklist of IFRS reveleations.

- The objective of this is to provide useful financial information for investors as well as to other lenders regarding their decision making when supplying resources to the entity.
- This practical declaration is not an IFRS and therefore entities aren't forced to abide by them, although, materiality is an omnipresent principle within IFRS.

In practical terms this document presents definitions in relation to materiality, users and judgement, as well as providing a 4 step model for the process of materiality.

Steps	**Process**
Step 1 – Identify	· Identify information that has potential to be material
Step 2 – Evaluate	· Evaluate if the identified information in step 1 is material
Step 3 – Organize	· Organize the information within the financial statements draft in a way that comunicates the information in a clear and concise manner
Step 4 – Review	· Review the financial statements draft to determine if all the material information has been identified and this materiality has been entirely considered from a broad perspective, in order to obtain complete financial statements

This declaration does not have an effective date because it is not a norm but a practice declaration, although it can be applied immediately. *Management will consider this declaration in the preparation of its financial statements starting from this date.*

Amendment to IAS 28 Long-Term Participations in Associates and Joint Ventures - On October 12, 2017, the IASB published this amendment to clarify that an entity would also apply IFRS 9 to a long-term participation in an associate or joint venture to which the participation method does not apply. When applying IFRS 9, the adjustments of the long-term participations arising from the application of this Standard will not be taken into account.

This amendment is effective retroactively in accordance with IAS 8 for annual periods beginning on or after January 1, 2019, except as specified in paragraphs 45G and 45J. Permit your anticipate app. If an entity applies the changes in a period that begins before, it will reveal that fact. *The Bank's Administration is evaluating the potential impact of this modification.*

Annual Improvements, cycle 2015-2017 - This amendment published on December 12, 2017 introduces the following improvements:

IFRS 3 Business Combinations / IFRS 11 Joint Agreements: deals with the prior interest in a joint operation, as a business combination in stages.

IAS 12 Income Tax: deals with the consequences in income tax of payments of classified financial instruments as heritage.

IAS 23 Loan costs: deals with the eligible costs for capitalization.

This amendment is effective for annual periods beginning on or after January 1, 2019. *The Bank's Administration will is evaluating the potential impact of this modification.*

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 02

SIGNIFICANT EVENTS

I.- As of December 31, 2017, the following significant events have occurred and affected the Bank's operations and Consolidated Financial Statements.

a) Bylaws and The Board

On April 5, 2017, the bylaws of Banco Santander Chile, approved at the Extraordinary Shareholders' Meeting held on January 9, 2017, were published in the Official Gazette, whose minutes were reduced to a public deed on February 14, 2017, in Nancy de la Fuente Hernández's Notary of Santiago. Among others, a consolidated text of the bylaws was established and, after the reforms introduced, its essential clauses are the following:

- Name: Banco Santander-Chile
- Purpose: The execution or conclusion of all acts, contracts, businesses or operations that the laws, especially the General Law of Banks, allow the banks to perform without prejudice to extend or restrict their sphere of action in harmony with the legal provisions in force Or that are established in the future, without the need to amend the present statutes.
- Capital: $ 891,302,881,691, divided into 188,446,126,794 nominative shares, with no par value, of the same and only series.
- Directory: Corresponds to a Board composed of 9 full members and 2 alternates.

At the Ordinary Shareholders' Meeting held on April 26, 2017, the Board of Directors was elected for a period of three years, consisting of nine Principal Directors and two Alternate Directors. The following persons were elected:

Principal Directors: Vittorio Corbo Lioi, Oscar von Chrismar Carvajal, Roberto Méndez Torres, Juan Pedro Santa María Pérez, Ana Dorrego de Carlos, Andreu Plaza López, Lucia Santa Cruz Sutil, Orlando Poblete Iturrate and Roberto Zahler Mayanz.

Alternate Directors: Blanca Bustamante Bravo and Raimundo Monge Zegers

b) Use of Profits and Distribution of Dividends

At the Ordinary General Shareholders' Meeting held on April 26, 2017, together with approving the Financial Statements for 2016, it was agreed to distribute 70% of the net profits for the year (which are denominated in the financial statements "Profit attributable to holders Of the Bank "), which amounted to Ch $ 472,351 million. These profits correspond to a dividend of $ 1.75459102 per share.

Likewise, it was approved that the remaining 30% of the profits be destined to increase the Bank's reserves.

c) Appointment of External Auditors

At the Board mentioned above, it was agreed to appoint the firm PricewaterhouseCoopers Consultores, Auditores SpA, as external auditors of the Bank and its subsidiaries for 2017.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 02

SIGNIFICANT EVENTS, continued

d) Issuance of bonds – As of December 31 2017

d.1) Senior bonds year 2017

In the year ended December 31, 2017 the Bank has issued senior bonds int the amount of USD 770,000,000 and AUD 30,000,000 Debt issuance information is included in Note 18.

Serie	Currency	Amount	Term	Issuance rate	Issuance date	Issuance amount	Maturity date
DN	USD	100,000,000	3.0	Libor-USD 3M+0.80%	20-07-2017	100,000,000	27-07-2020
DN	USD	50,000,000	3.0	Libor-USD 3M+0.80%	21-07-2017	50,000,000	27-07-2020
DN	USD	50,000,000	3.0	Libor-USD 3M+0.80%	24-07-2017	50,000,000	27-07-2020
DN	USD	10,000,000	4.0	Libor-USD 3M+0.83%	23-08-2017	10,000,000	23-11-2021
DN	USD	10,000,000	4.0	Libor-USD 3M+0.83%	23-08-2017	10,000,000	23-11-2021
DN	USD	50,000,000	3.0	Libor-USD 3M+0.75%	14-09-2017	50,000,000	15-09-2020
DN	USD	500,000,000	3.0	2.50%	12-12-2017	500,000,000	15-12-2020
Total	USD	770,000,000				770,000,000	
AUD	AUD	30,000,000	10.0	3.96%	05-12-2017	30,000,000	12-12-2027
Total	AUD	30,000,000				30,000,000	

.d.2) Subordinated bonds year 2017

As of December 2017, the Bank did not issue subordinated bonds.

d.3) Mortgage bonds year 2017

As of December 2017, the Bank did not issue mortgage bonds.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 02

SIGNIFICANT EVENTS, continued

d.4) Repurchased bonds year 2017

In the nine months ended December 31, 2017 the Bank has repurchased the following bonds:

Date	Type	**Amount**	
06-03-2017	Senior	USD	6,900,000
12-05-2017	Senior	UF	1,000,000
16-05-2017	Senior	UF	690,000
17-05-2017	Senior	UF	15,000
26-05-2017	Senior	UF	340,000
01-06-2017	Senior	UF	590,000
02-06-2017	Senior	UF	300,000
05-06-2017	Senior	UF	130,000
19-06-2017	Senior	UF	265,000
10-07-2017	Senior	UF	770,000
21-07-2017	Senior	UF	10,000
28-08-2017	Senior	UF	400,000
29-08-2017	Senior	UF	272,000
03-11-2017	Senior	UF	14,000
29-11-2017	Senior	UF	400,000
06-12-2017	Senior	UF	20,000
12-12-2017	Senior	CLP	10,990,000,000

II.- As of December 31, 2016, the following significant events have occurred and affected the Bank’s operations and Consolidated Financial Statements.

a) Directory

At the Ordinary Shareholders' Meeting held on April 26, 2016, the appointment of titular directors, Mr. Andreu Plaza López and Mrs. Ana Dorrego de Carlos was ratified, who were appointed as titular directors at the Ordinary Meeting of the Board of Directors held on October 20, 2015.

At the Ordinary Session of the Board of Directors held on March 15, 2016, Víctor Arbulú Crousillat resigned as director. In view of his resignation and the vacancy left in at a past moment by Mr. Lisandro Serrano Spoerer, on the occasion of his resignation at the Ordinary Session of the Board of Directors held on October 20, 2015, the Board appointed Mr. Andreu Plaza López and Mrs. Ana Dorrego de Carlos. Finally, it is reported that on the occasion of the resignation of Mr. Victor Arbulú Crousillat he has been appointed as a member of the Directors and Audit Committee and in his replacement, Mr. Mauricio Larraín Garcés.

b) Use of Profits and Distribution of Dividends

At the Ordinary General Shareholders' Meeting held on April 26, 2016, Mr. Oscar von Chrismar Carvajal (First Vice-Chairman), Mr. Roberto Méndez Torres (Second Vice-President), titular directors Marco Colodro Hadjes, Lucia Santa Cruz Sutil, Ana Dorrego de Carlos, Mauricio Larraín Garcés, Juan Pedro Santa María, Orlando Poblete Iturrate, Andreu Plaza Lopez and Blanca Bustamante Bravo participated in ameeting with Mr. Vittorio Corbo Lioi as Chairman. In addition, the General Manager Mr. Claudio Melandri Hinojosa and the Manager of Strategic Planning Mr. Raimundo Monge also attend to the meeting.

According to the information presented in the Meeting mentioned above, net income for year 2015 (referred to in the financial statements "Profit attributable to equity holders of the Bank"), amounted to Ch$ 448,878 million. It was approved to distribute 75% of said profits, which, divided by the number of shares issued, correspond to a dividend of $ 1,78649813 per share, which began to be paid as of April 29, 2016.

Likewise, it is approved that the remaining 25% of the profits be destined to increase the Bank's reserves.

c) Appointment of External Auditors

At the Board mentioned above, it was agreed to appoint the firm PricewaterhouseCoopers Consultores, Auditores SpA, as external auditors of the Bank and its subsidiaries for 2016.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 02

SIGNIFICANT EVENTS, continued

d) Capital increase of Transbank S.A.

At the Extraordinary Shareholders' Meeting of Transbank S.A. Held on April 21, 2016, it was agreed to increase the capital of the company by capitalizing the accumulated profits, through the issuance of shares redeemed for payment, and placement of payment shares for approximately $ 4,000 million. Banco Santander Chile participated proportionally to its participation (25%), reason why it subscribed and paid shares for approximately $ 1 billion.

e) Issuance of bank bonds - As of December 31, 2016:

As of December 31, 2016, the Bank has issued bonds for UF 145,000,000, CLP 200,000,000,000, USD 30,000,000 and JPY 3,000,000,000 and EUR 74,000,000. The detail of the placements made as of December 31, 2016 is included in Note 15.

e.1 Senior Bonds as of December 31, 2016

In the year ended December 31, 2016 the Bank has issued senior bonds int the amount of UF 96,000,000, CLP 100,000,000,000, USD 215,000,000, JPY 3,000,000,000, EUR 104,000,000 y CHF 125,000,000, Debt issuance information is included in Note 18.

Set	Currency	Amount	Term Original (annual)	Yearly Issuance rate	Date of issue	Due date

T1	UF	7,000,000	4.0	2.20	%	01-02-2016	01-02-2020
T2	UF	5,000,000	4.5	2.25	%	01-02-2016	01-08-2020
T3	UF	5,000,000	5.0	2.30	%	01-02-2016	01-12-2020
T4	UF	8,000,000	5.5	2.35	%	01-02-2016	01-08-2021
T5	UF	5,000,000	6.0	2.40	%	01-02-2016	01-02-2022
T6	UF	5,000,000	6.5	2.45	%	01-02-2016	01-08-2022
T7	UF	5,000,000	7.0	2.50	%	01-02-2016	01-02-2023
T8	UF	8,000,000	7.5	2.55	%	01-02-2016	01-08-2023
T9	UF	5,000,000	8.0	2.60	%	01-02-2016	01-02-2024
T10	UF	5,000,000	8.5	2.60	%	01-02-2016	01-08-2024
T11	UF	5,000,000	9.0	2.65	%	01-02-2016	01-02-2025
T12	UF	5,000,000	9.5	2.70	%	01-02-2016	01-08-2025
T13	UF	5,000,000	10.0	2.75	%	01-02-2016	01-02-2026
T14	UF	18,000,000	11.0	2.80	%	01-02-2016	01-02-2027
T15	UF	5,000,000	12.5	3.00	%	01-02-2016	01-08-2028
Total	UF	96,000,000					
T16	CLP	100,000,000,000	5.5	5.20	%	01-02-2016	01-08-2021
Total	CLP	100,000,000,000					
DN	USD	10,000,000	5.0	Libor-USD 3M+1.05	%	02-06-2016	09-06.2021
DN	USD	10,000,000	5.0	Libor-USD 3M+1.22	%	08-06-2016	17-06-2021
DN	USD	10,000,000	5.0	Libor-USD 3M+1.20	%	01-08-2016	16-08-2021
DN	USD	185,000,000	5.0	Libor-USD 3M+1.20	%	10-11-2016	28-11-2021
Total	USD	215,000,000					
JPY	JPY	3,000,000,000	5.0	0.115	%	22-06-2016	29-06-2021
Total	JPY	3,000,000,000					
EUR	EUR	20,000,000	8.0	0.80	%	04-08-2016	19-08-2024
EUR	EUR	54,000,000	12.0	1.307	%	05-08-2016	17-08-2028
EUR	EUR	30,000,000	3.0	0.25	%	09-12-2016	20-12-2019
Total	EUR	104,000,000					
CHF	CHF	125,000,000	8.5	0.35	%	14-11-2016	30-05-2025
Total	CHF	125,000,000					

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 02

SIGNIFICANT EVENTS, continued

e.2 Subordinated Bonds as of December 31, 2016

As of December 2016, the Bank did not issue subordinated bonds.

e.3 Mortgage bonds as of December 31, 2016

As of December 2016, the Bank did not issue mortgage bonds.

e.4 Repurchased bonds

As of 2016 the Bank has repurchased the following bonds:

Fecha	Tipo	**Monto**	
13-01-2016	Senior	USD	600,000
27-01-2016	Senior	USD	960,000
08-03-2016	Senior	USD	481,853,000
08-03-2016	Senior	USD	140,104,000
10-05-2016	Senior	USD	10,000,000
29-11-2016	Senior	USD	6,895,000

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 03

REPORTING SEGMENTS

The Bank manages and measures the performance of its operations by business segments. The information disclosed in this note is not necessarily comparable to that of other financial institutions, since it is based on management's internal information system by segment.

Inter-segment transactions are conducted under normal arm's length commercial terms and conditions. Each segment's assets, liabilities, and income include items directly attributable to the segment to which they can be allocated on a reasonable basis.

In order to achieve compliance with the strategic objectives established by senior management and adapt to changing market conditions, from time to time, the Bank makes adjustments in its organization, modifications that in turn impact to a greater or lesser extent, in the way in which it is managed or managed. Thus, the present disclosure provides information on how the Bank is managed as of December 31, 2017. Regarding the information corresponding to the year 2016, it has been prepared with the current criteria at the closing of these financial statements in order to achieve the duecomparability of the figures.

The Bank has the reportable segments noted below:

Retail Banking

Consists of individuals and small to middle-sized entities (SMEs) with annual income less than Ch$1,200 million. This segment gives customers a variety of services, including consumer loans, credit cards, auto loans, commercial loans, foreign exchange, mortgage loans, debit cards, checking accounts, savings products, mutual funds, stockbrokerage, and insurance brokerage. Additionally the SME clients are offered government-guaranteed loans, leasing and factoring.

Middle-market

This segment is made up of companies and large corporations with annual sales exceeding Ch$1,200 million. It serves institutions such as universities, government entities, local and regional governments and companies engaged in the real estate industry who carry out projects to sell properties to third parties and annual sales exceeding Ch$800 million with no upper limit. The companies within this segment have access to many products including commercial loans, leasing, factoring, foreign trade, credit cards, mortgage loans, checking accounts, transactional services, treasury services, financial consulting, savings products, mutual funds, and insurance brokerage. Also companies in the real estate industry are offered specialized services to finance residential projects, with the aim of expanding sales of mortgage loans.

Global Corporate Banking

This segment consists of foreign and domestic multinational companies with sales over Ch$10,000 million. The companies within this segment have access to many products including commercial loans, leasing, factoring, foreign trade, credit cards, mortgage loans, checking accounts, transactional services, treasury services, financial consulting, investments, savings products, mutual funds and insurance brokerage.

This segment also consists of a Treasury Division which provides sophisticated financial products, mainly to companies in the Middle-market and Global Corporate Banking segments. These include products such as short-term financing and fund raising, brokerage services, derivatives, securitization, and other tailor-made products. The Treasury area may act as brokers to transactions and also manages the Bank's investment portfolio.

Corporate Activities ("Other")

This segment mainly includes the results of our Financial Management Division, which develops global management functions, including managing inflation rate risk, foreign currency gaps, interest rate risk and liquidity risk. Liquidity risk is managed mainly through wholesale deposits, debt issuances and the Bank's available for sale portfolio. This segment also manages capital allocation by unit. These activities usually result in a negative contribution to income.

Banco Santander Chile and Subsidiaries

Notes to the Consolidated Financial Statements

AS OF DECEMBER 31, 2017 AND 2016

NOTE 03

REPORTING SEGMENTS, continued

In addition, this segment encompasses all the intra-segment income and all the activities not assigned to a given segment or product with customers.

The segments' accounting policies are those described in the summary of accounting policies. The Bank earns most of its income in the form of interest income, fee and commission income and income from financial operations. To evaluate a segment's financial performance and make decisions regarding the resources to be assigned to segments, the Chief Operating Decision Maker (CODM) bases his assessment on the segment's interest income, fee and commission income, and expenses.

Below are the tables showing the Bank's results by business segment, for the periods ending as of December 31, 2017 and 2016:

	December 31, 2017						
	Loans and accounts receivable from customers (1)	Net interest income	Net fee and commission income	Financial transactions, net (2)	Provision for loan losses	Support expenses (3)	Segment`s net contribution
	MCh$	MCh$	MCh$	MCh$	MCh$	MCh$	MCh$
Retail Banking	19,233,169	970,332	206,449	20,595	(290,156)	(534,970)	372,250
Middle-market	6,775,734	264,663	36,280	13,751	(19,312)	(91,882)	203,500
Commercial Banking	26,008,903	1,234,995	242,729	34,346	(309,468)	(626,852)	575,750

Global Corporate Banking	1,633,796	100,808	27,626	50,714	4,008	(62,685)	120,471
Other	83,215	(9,112)	8,708	44,692	6,255	(15,356)	35,187
Total	27,725,914	1,326,691					

23.2	Consent of Independent Public Accountants L.L. Bradford and Company, LLC.
31.1	Certificate furnished pursuant to 18 U.S.C 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certificate furnished pursuant to 18 U.S.C 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of

	2002.
32.2	Certifications of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
99	Cautionary Statement for Purpose of the "Safe Harbor" Provisions of the Private Securities Reform Act of 1995.
101	The following financial information from the Company's Annual Report on Form 10-K for the year ended April 30, 2015, formatted in XBRL (eXtensible Business Reporting Language) includes; (i) Consolidated Balance Sheets as of April 30, 2015 and 2014; (ii) Consolidated

Statements of Operations for the years ended April 30, 2015, 2014 and 2013; (iii) Consolidated Statements of Stockholders' Equity for the years ended April 30, 2015, 2014 and 2013; (iv) Consolidated Statements of Cash Flows for the years ended April 30, 2015, 2014 and 2013, and (v) the Notes to Consolidated Financial Statements, with detail tagging.

* Relates to management contract, compensatory plan or arrangement.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

July 29, 2015

BUTLER NATIONAL CORPORATION

/s/ Clark D. Stewart
Clark D. Stewart, President
and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant in the capacities and on the dates indicated:

Signature	Title	Date
/s/ Clark D. Stewart Clark D. Stewart	President, Chief Executive Officer and Director (Principal Executive Officer)	July 29, 2015
/s/ Craig D. Stewart Craig D. Stewart	Chief Financial Officer (Principal Accounting Officer)	July 29, 2015
/s/ R. Warren Wagoner R. Warren Wagoner	Chairman of the Board and Director	July 29, 2015
/s/ David B. Hayden David B. Hayden	Director	July 29, 2015
/s/ Michael J. Tamburelli Michael J. Tamburelli	Director	July 29, 2015
/s/ Bradley K. Hoffman Bradley K. Hoffman	Director	July 29, 2015

Report of Independent Registered Public Accounting Firm

Stockholders and Directors
Butler National Corporation
Olathe, Kansas

We have audited the accompanying consolidated balance sheet of Butler National Corporation as of April 30, 2015 and the related consolidated statements of operations, stockholders' equity, and cash flows for the year ended April 30, 2015. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated balance sheet of Butler National Corporation as of April 30, 2015 and the consolidated results of its operations, stockholders' equity, and cash flows for the year ended April 30, 2015 in conformity with U.S. generally accepted accounting principles.

/s/ RBSM, LLP
Leawood, Kansas
July 29, 2015

Report of Independent Registered Public Accounting Firm

Stockholders and Directors
Butler National Corporation
Olathe, Kansas

We have audited the accompanying consolidated balance sheets of Butler National Corporation as of April 30, 2014 and 2013 and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the two years in the years ended April 30, 2014. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatements. The company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Butler National Corporation as of April 30, 2014 and 2013 and the consolidated results of its operations, stockholders' equity, and cash flows for each of the two years in the years ended April 30, 2014 in conformity with U.S. generally accepted accounting principles.

/s/ L. L. Bradford & Company, LLC
Leawood, Kansas
July 29, 2014

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AS OF APRIL 30, 2015 AND 2014
(in thousands, except per share data)

	April 30, 2015	April 30, 2014
ASSETS		
CURRENT ASSETS:		
Cash	$6,195	$6,261
Accounts receivable	1,724	3,109
Inventories		
Raw materials	5,277	5,102
Work in process	1,364	1,090
Finished goods	396	144
Total Inventory	7,037	6,336
Prepaid expenses and other current assets	862	825
Total current assets	15,818	16,531
PROPERTY, PLANT AND EQUIPMENT:		
Land and building	4,071	4,044
Aircraft	7,493	6,723
Machinery and equipment	3,612	3,535
Office furniture and fixtures	5,396	6,447
Leasehold improvements	4,081	4,060
	24,653	24,809
Accumulated depreciation	(13,473)	(12,140)
Total property, plant and equipment	11,180	12,669
SUPPLEMENTAL TYPE CERTIFICATES (net of accumulated amortization of $2,975 at April 30, 2015 and $2,841 at April 30, 2014)	5,863	3,744
OTHER ASSETS:		
Deferred tax asset	1,197	1,335
Other assets (net of accumulated amortization of $4,050 at April 30, 2015 and $2,520 at April 30, 2014)	7,540	7,399
Total other assets	8,737	8,734
Total assets	$41,598	$41,678
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Promissory notes	$1,510	$1,757
Current maturities of long-term debt	2,412	3,908
Accounts payable	1,874	1,375
Customer deposits	837	982
Gaming facility mandated payment	1,299	1,267
Compensation and compensated absences	1,294	1,122
Other current liabilities	100	93
Total current liabilities	9,326	10,504

LONG-TERM DEBT, NET OF CURRENT MATURITIES:	6,870	6,820
Total liabilities	16,196	17,324
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY:		
Preferred stock, par value $5:		
Authorized 50,000,000 shares, all classes		
Designated Classes A and B 200,000 shares		
$100 Class A, 9.8%, cumulative if earned liquidation and redemption value $100, no shares issued and outstanding	-	-
$1,000 Class B, 6%, convertible cumulative, liquidation and redemption value $1,000, no shares issued and outstanding	-	-
Common stock, par value $.01:authorized 100,000,000 shares issued and outstanding 62,860,098 shares at April 30, 2015 and 61,493,092 at April 30, 2014	628	614
Capital contributed in excess of par	13,487	13,282
Treasury stock at cost, 600,000 shares	(732)	(732)
Retained earnings	8,161	8,134
Total stockholders' equity Butler National Corporation	21,544	21,298
Noncontrolling interest in BHCMC, LLC	3,858	3,056
Total stockholders' equity	25,402	24,354
Total liabilities and stockholders' equity	$41,598	$41,678
The accompanying notes are an integral part of these financial statements		

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED APRIL 30, 2015, 2014, AND 2013
(in thousands, except per share data)

	2015	2014	2013
REVENUES:			
Professional Services	$30,795	$31,022	$35,525
Aerospace Products	16,267	16,249	13,627
Total revenues	47,062	47,271	49,152
COSTS AND EXPENSES:			
Cost of Professional Services	18,798	18,843	21,090
Cost of Aerospace Products	12,672	12,129	11,451
Marketing and advertising	4,323	4,286	4,223
Employee benefits	1,825	2,084	2,161
Depreciation and amortization	2,885	3,495	3,276
General, administrative and other	5,240	4,513	5,448
Total costs and expenses	45,743	45,350	47,649
OPERATING INCOME	1,319	1,921	1,503
OTHER INCOME (EXPENSE):			
Interest expense	(1,141)	(1,417)	(1,521)
Other income (expense), net	16	43	11
Gain on settlement	773	-	-
Total other income (expense)	(352)	(1,374)	(1,510)
INCOME (LOSS) BEFORE INCOME TAXES	967	547	(7)
PROVISION FOR INCOME TAXES			
Deferred income tax (benefit)	138	(33)	(136)
Provision (benefit) for income taxes	-	66	(680)
NET INCOME	829	514	809
Net income attributable to noncontrolling interest in BHCMC, LLC	(802)	(402)	(957)
NET INCOME (LOSS) ATTRIBUTABLE TO BUTLER NATIONAL CORPORATION	$27	$112	$(148)
BASIC EARNINGS PER COMMON SHARE	$.00	$.00	$.00
WEIGHTED AVERAGE SHARES USED IN PER SHARE CALCULATION	62,260,098	60,893,092	59,014,594
DILUTED EARNINGS PER COMMON SHARE	$.00	$.00	$.00
WEIGHTED AVERAGE SHARES USED IN PER SHARE CALCULATION	62,260,098	60,893,092	59,014,594

The accompanying notes are an integral part of these financial statements

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
FOR THE YEARS ENDED April 30, 2015, 2014 AND 2013
(dollars in thousands)

	Common Stock	Common Stock Owed but Not Issued	Capital Contributed in Excess of Par	Treasury Stock at Cost	Retained Earnings	Total Stockholders Equity Butler National Corporation	Noncontrolling Interest in BHCMC, LLC	Total Stockholders' Equity
BALANCE, April 30, 2012	$ 579	$ 3	$ 12,567	$ (732)	$ 8,170	$ 20,587	$ 2,017	$ 22,604
Issuance of stock for services and other	2	(3)	91	-	-	-	-	90
Stock options issued to employees and directors	-	-	110	-	-	110	-	110
BHCMC distribution noncontrolling member	-	-	-	-	-	-	(320)	(320)
Issuance of stock benefit plan	15	-	266	-	-	281	-	281
Net income	-	-	-	-	(148)	(148)	957	809
BALANCE, April 30, 2013	596	-	13,034	(732)	8,022	20,920	2,654	23,574
Stock options issued to employees and directors	-	-	22	-	-	22	-	22
Issuance of stock benefit plan	18	-	226	-	-	244	-	244
Net income	-	-	-	-	112	112	402	514
BALANCE, April 30, 2014	614	-	13,282	(732)	8,134	21,298	3,056	24,354
Issuance of stock benefit plan	14	-	205	-	-	219	-	219
Net income	-	-	-	-	27	27	802	829
BALANCE, April 30, 2015	$ 628	$ -	$ 13,487	$ (732)	$ 8,161	$ 21,544	$ 3,858	$ 25,402

The accompanying notes are an integral part of these financial statements.

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED April 30, 2015, 2014, AND 2013
(dollars in thousands)

	2015	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income	$829	$514	$809
Adjustments to reconcile cash flows from operating activities			
Depreciation and amortization	4,032	4,481	3,528
Stock issued for services	-	-	90
Stock options issued to employees and directors	-	22	110
Stock issued for benefit plan	219	244	281
Gain and loss on disposal of other assets	-	(36)	-
Gain on settlement	(773)	-	-
Deferred income tax asset	138	(33)	(136)
Changes in assets and liabilities			
Accounts receivable	1,385	(273)	892
Income tax receivable	-	1,395	(1,395)
Inventories	(701)	(772)	207
Prepaid expenses and other current assets	(1,708)	(1,178)	(518)
Accounts payable	499	(133)	340
Customer deposits	(145)	789	(822)
Accrued liabilities	172	77	(344)
Gaming facility mandated payment	32	(70)	56
Other liabilities	7	(26)	(88)
Net cash provided by operating activities	3,986	5,001	3,010
CASH FLOWS FROM INVESTING ACTIVITIES			
Capital expenditures	(3,682)	(290)	(8,159)
Proceeds from settlement	1,323	-	-
Net cash used in investing activities	(2,359)	(290)	(8,159)
CASH FLOWS FROM FINANCING ACTIVITIES			
Borrowings promissory notes, net	(247)	380	915
Borrowings of long-term debt	7,587	1,070	5,780
Repayments of long-term debt	(9,033)	(5,048)	(3,509)
Distribution to noncontrolling member	-	-	(320)
Net cash (used in) provided by financing activities	(1,693)	(3,598)	2,866
NET INCREASE (DECREASE) IN CASH	(66)	1,113	(2,283)
CASH, beginning of year	6,261	5,148	7,431
CASH, end of year	$6,195	$6,261	$5,148
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION			
Interest paid	$1,141	$1,419	$1,520
Income taxes paid (refund)	$-	$(1,329)	$762

NON CASH OPERATING ACTIVITY			
Non cash stock issued for services	$-	$-	$90
Non cash stock options issued to employees and directors	$-	$22	$110
Non cash stock issued for benefit plan	$219	$244	$281

The accompanying notes are an integral part of these financial statements.

BUTLER NATIONAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(in thousands, except per share data)

1. NATURE OF OPERATIONS, ORGANIZATION:

The accompanying consolidated financial statements include the accounts of Butler National Corporation (BNC) and its wholly-owned active subsidiaries, Avcon Industries, Inc., AVT Corporation, BCS Design, Inc., Butler National Services, Inc. (sold May 1, 2013), Butler National Service Corporation, Butler National Corporation-Tempe, Butler Avionics, Inc., Butler National, Inc., Butler Temporary Services, Inc., Kansas International Corporation, Kansas International DDC, LLC, Wild West Heritage Foundation, Inc., and a majority owned subsidiary, BHCMC, LLC (collectively, The Company). All significant intercompany balances and transactions have been eliminated in consolidation. The fiscal year end of the Company is April 30.

Avcon Industries, Inc. modifies business category aircraft at its Newton, Kansas facility. Modifications can include passenger-to-freighter configuration, addition of aerial photography capability, and stability enhancing modifications. Butler Avionics sells, installs and repairs avionics equipment (airplane radio equipment and flight control systems). Butler National Inc. acquires airplanes, principally Learjets, to refurbish and sell. Butler National Corporation-Tempe is primarily engaged in the manufacture of airborne switching units used in Boeing McDonnell Douglas aircraft, electronic upgrades for classic weapon control systems used by the military and transient suppression devices for Boeing Classic aircraft. Butler National Service Corporation is a management consulting and administrative services firm providing business planning and financial coordination to Indian tribes interested in owning and operating casinos under the terms of the Indian Gaming Regulatory Act of 1988. BHCMC, LLC is majority-owned and provides management services for the Boot Hill Casino under a management agreement with the State of Kansas. BCS Design provides professional architectural services.

a) Accounts receivable: Accounts receivable are carried on a gross basis, with no discounting, less the allowance for doubtful accounts. Management estimates the allowance for doubtful accounts based on existing economic conditions, the financial conditions of the customers, and the amount and the age of past due accounts. Receivables are considered past due if full payment is not received by the contractual due date. Past due accounts are generally written off against the allowance for doubtful accounts only after all collection attempts have been exhausted. Allowance for doubtful accounts are calculated on the historical write-off of doubtful accounts of the individual subsidiaries. Invoices are generally considered a doubtful account if no payment has been made in the past 90 days. We review these policies on a quarterly basis, and based on these reviews, we believe we maintain adequate reserves. At April 30, 2015 and 2014, the allowance for doubtful accounts was $81 and $72 respectively.

b) Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to our financial statements.

c) Inventories: Inventories are priced at the lower of cost, determined on a first-in, first-out basis, or market. Inventories include material, labor and factory overhead required in the production of our products.

Inventory obsolescence is examined on a regular basis. When determining our estimate of obsolescence we consider inventory that has been inactive for three years or longer and the probability of using that inventory in future production. The obsolete inventory generally consists of Falcon and Learjet parts and electrical components. At April 30, 2015 and 2014, the estimate of obsolete inventory was $1,126 and $1,381 respectively.

d) Property and Related Depreciation: Machinery and equipment are recorded at cost and depreciated over their estimated useful lives. Depreciation is provided on a straight-line basis. The lives used for the significant items within each property classification range from 3 to 39 years.

Maintenance and repairs are charged to expense as incurred. The cost and accumulated depreciation of assets retired are removed from the accounts and any resulting gains or losses are reflected as income or expense.

e) Long-Lived Assets: The Company accounts for its long-lived assets in accordance with ASC Topic 360-10, formerly SFAS No. 144 "Accounting for the Impairment or Disposal of Long-Lived Assets." ASC Topic 360-10 requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the historical cost carrying value of an asset may no longer be appropriate. The Company assesses recoverability of the carrying value of an asset by estimating the future net cash flows expected to result from the asset, including eventual disposition. If the future net cash flows are less than the carrying value of the asset, an impairment loss is recorded equal to the difference between the asset's carrying value and fair value or disposable value.

f) Other Assets: Our other asset account includes assets of $5,500 related to the Kansas Expanded Lottery Act Management Contract privilege fee, $3,635 of gaming equipment we were required to pay for ownership by the State of Kansas Lottery, and JET autopilot intellectual property of $1,417, and miscellaneous other assets of $1,038. BHCMC expects the $5,500 privilege fee to have a value over the remaining life of the Management Contract with the State of Kansas which will end in December 2024. There is no assurance of the Management Contract renewal. The Managers Certificate asset for use of gaming equipment is being amortized over a period of three years based on the estimated useful life of gaming equipment. The JET intellectual property is being amortized over a period of 15 years.

Other assets net values are as follows:

(dollars in thousands)	2015	2014
Privilege fee	$5,500	$5,500
Less amortized costs	1,410	987
Privilege fee balance	$4,090	$4,513
Intangible gaming equipment	$3,635	$2,252
Less amortized costs	1,961	948
Intangible gaming equipment balance	$1,674	1,304
JET autopilot intellectual property	$1,417	$1,417
Less amortized costs	679	585
JET autopilot balance	$738	$832

g) Supplemental Type Certificates: Supplemental Type Certificates (STCs) are authorizations granted by the Federal Aviation Administration (FAA) for specific modification of a certain aircraft. The STC authorizes us to perform modifications, installations, and assemblies on applicable customer-owned aircraft. Costs incurred to obtain STCs are capitalized and subsequently amortized against revenues being generated from aircraft modifications associated with the STC. The costs are expensed as services are rendered on each aircraft through costs of sales using the units of production method. The legal life of an STC is indefinite. We believe we have enough future sales to fully amortize our STC development costs. Consultant costs, as shown below, include costs of engineering, legal and aircraft specialists. STC capitalized costs are as follows:

(dollars in thousands) 2015 2014

Direct labor	$1,709	$1,033
Direct materials	2,336	1,833
Consultant costs	1,922	1,922
Overhead	2,871	1,797
	8,838	6,585
Less-amortized costs	2,975	2,841
STC balance	$5,863	$3,744

h) Revenue Recognition: Generally, we perform aircraft modifications under fixed-price contracts. Revenue from fixed-price contracts are recognized on the percentage-of-completion method, measured by the direct labor incurred compared to total estimated direct labor and material costs. Each quarter our management reviews the progress and performance of our significant contracts. Based on this analysis, any adjustment to sales, cost of sales and/or profit is recognized as necessary in the period they are earned. Changes in estimates of contract sales, cost of sales and profits are recognized using a cumulative catch-up, which is recognized in the current period of the cumulative effect of the change on current or prior periods. Revenue for off-the-shelf items and aircraft sales is recognized on the date of sale.

Revenue from product sales is recognized when shipped. Payment for these Avionics products is due within 30 days of the invoice date after shipment. Revenue from Gaming Management and other Corporate/Professional Services is recognized as the service is rendered and invoiced. Payments for these service invoices are usually received within 30 days.

In regard to warranties and returns, our products are special order and are not suitable for return. Our products are unique upon installation and tested prior to their release to the customer and acceptance by the customer. In the rare event of a warranty claim, the claim is processed through the normal course of business and may include additional charges to the customer. In our opinion any future warranty work would not be material to the financial statements.

Gaming revenue is the gross gaming win as reported by the Kansas Lottery casino reporting systems, less the mandated payments by and for the State of Kansas. Electronic games-slots and table games revenue is the aggregate of gaming wins and losses. Liabilities are recognized for chips and "ticket-in, ticket-out" coupons in the customers' possession, and for accruals related to anticipated payout of progressive jackpots. Progressive gaming machines, which contain base jackpots that increase at a progressive rate based on the number of coins played, are deducted from revenue as the amount of jackpots increase. Food, beverage, and other revenue is recorded when the service is received and paid for.

i) Slot Machine Jackpots: If the casino is not required to make payment of the jackpot (i.e. the incremental amount on a progressive machine) due to legal requirements, the jackpot is accrued as the obligation becomes unavoidable. This liability is accrued over the time period in which the incremental progressive jackpot amount is generated with a related reduction in casino revenue. No liability is accrued with respect to the base jackpot.

j) Advanced Payments and Billings in Excess of Costs Incurred: We receive advances, performance-based payments and progress payment from customers which may exceed costs incurred on certain contracts. We classify advance payments and billings in excess of costs incurred, other than those reflected as a reduction of contracts in process, as current liabilities.

k) Earnings Per Share: Earnings per common share is based on the weighted average number of common shares outstanding during the year. Stock options have been considered in the dilutive earnings per share calculation.

The computation of the Company basic and diluted earnings per common share is as follows:

(in thousands, except per share data)	2015	2014	2013
Net income (loss) attributable to Butler National Corporation	$27	$112	$(148)
Weighted average common shares outstanding	62,260,098	60,893,092	59,014,594
Dilutive effect of non-qualified stock option plans	-	-	-
Weighted average common shares outstanding, assuming dilution	62,260,098	60,893,092	59,014,594
Potential common shares if all options were exercised and shares issued	69,522,162	68,155,156	66,281,237
Basic earnings per common share	$.00	$.00	$.00
Diluted earnings per common share	$.00	$.00	$.00

l) Stock-based Compensation: The Company accounts for stock-based compensation under ASC Topic 505-50, formerly SFAS No. 123R, "Share-Based Payment" and SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure - An amendment to SFAS No. 123." These standards define a fair value based method of accounting for stock-based compensation. In accordance with SFAS Nos. 123R and 148, the cost of stock-based compensation is measured at the grant date based on the value of the award and is recognized over the vesting period. The value of the stock-based award is determined using the Black-Scholes option-pricing model, whereby compensation cost is the excess of the fair value of the award as determined by the pricing model at the grant date or other measurement date over the amount that must be paid to acquire the stock. The resulting amount is charged to expense on the straight-line basis over the period in which the Company expects to receive the benefit, which is generally the vesting period.

m) Income Taxes: Amounts provided for income tax expense are based on income reported for financial statement purposes and do not necessarily represent amounts currently payable under tax laws. Deferred taxes, which arise principally from temporary differences between the period in which certain income and expense items are recognized for financial reporting purposes and the period in which they affect taxable income, are included in the amounts provided for income taxes. Under this method, the computation of deferred tax assets and liabilities give recognition to enacted tax rates in effect in the year the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to amounts that we expect to realize.

n) Cash and Cash Equivalents: Cash and cash equivalents consist primarily of cash and investments in a money market fund. We consider all highly liquid investments with an original maturity of three months or less to be cash equivalents. We maintain cash in bank deposit accounts that, at times, may exceed federally insured limits. At April 30, 2015 we had $2,250 in bank deposits that exceeded the federally insured limits.

o) Concentration of Credit Risk: We extend credit to customers based on an evaluation of their financial condition and collateral is not required. We perform ongoing credit evaluations of our customers and maintain an allowance for doubtful accounts.

p) Research and Development: We invested in research and development activities. The amount invested in the year ended April 30, 2015 and 2014 was $2,048 and $1,765 respectively.

q) Recent Accounting Pronouncements: We do not believe there are any recently issued accounting standards that have not yet been adopted that will have a material impact on the Company's financial statements.

r) Reclassifications: Certain reclassifications within the financial statement captions have been made to maintain consistency in presentation between years.

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2. DEBT:

Principal amounts of debt at April 30, 2015 and 2014, consist of the following (in thousands):

Promissory Notes	2015	2014
Bank line of credit, available LOC $1.0 million interest at prime plus 2% (7.0% at April 30, 2015 - with a floor of 7%) due August 2015, collateralized by a first or second position on all assets of the Company.	$700	$908
Bank line of credit, available LOC $2.5 million interest at 6% due May 2016, collateralized by a first or second position on all assets of the Company.	656	699
Bank line of credit, available LOC $1.0 million interest at 3.4% due May 2016, collateralized by real estate.	154	150
	$1,510	$1,757

Long-Term Debt		
Note payable, interest at 6% due February 2016 collateralized by Aircraft Security Agreements.	$314	$671
Note payable, interest at 6% due April 2017 collateralized by Aircraft Security Agreements.	159	232
Note payable, interest at 6.25% due September 2017 collateralized by Aircraft Security Agreements.	249	342
Note payable, interest at 5.75% due January 2020 collateralized by Aircraft Security Agreements	674	-
Note payable, interest at bank prime (3.36% at April 30, 2015) due August 2019, collateralized by real estate.	253	312
Note payable, interest at bank prime (3.36% at April 30, 2015) due March 2019, collateralized by real estate.	261	323
Note payable, interest at bank prime (2.68% at April 30, 2015) due March 2019, collateralized by real estate.	628	788
Note payable, interest at 6.25%, due June 2016, collateralized by real estate.	306	320
Note payable, interest at 4.89% due May 2020, collateralized by all of BNSC's assets and compensation due under the State Management contract.	5,500	-
Obligation of BHCMC, LLC to its noncontrolling owner with interest at 12.0%, paid off in April 2015.	-	1,900
Obligation of BHCMC, LLC to its noncontrolling owner with interest at 15.0%, paid off in April 2015.	-	4,634
Obligations of BHCMC, LLC due May 2015 and December 2016 with interest rates at 3.5%.	895	1,126
Other notes payable, due April 2016 with interest at 5.8%.	43	80

	9,282	10,728
Less: Current maturities	2,412	3,908
	$6,870	$6,820

Maturities of long-term debt are as follows:

Year Ending April 30	Amount
2016	$ 2,412
2017	2,285
2018	1,577
2019	1,576
2020	1,328
Thereafter	104
	$ 9,282

Financial and Other Covenants
We are in compliance with our covenants at April 30, 2015.

3. INCOME TAXES:

Deferred taxes are determined based on the estimated future tax effects of differences between the financial statements and tax basis of assets and liabilities given the provision of the enacted tax laws. Significant components of the Company's deferred tax liabilities and assets as of April 30, 2015 and 2014 are as follows (in thousands):

	April 30, 2015	April 30, 2014
Deferred tax liabilities:		
Depreciation	$ (178)	$ (352)
Deferred tax assets:		
Accounts receivable allowance	28	28
Inventory and other allowances	1,154	1,548
Vacation accruals	117	111
NOL carryforward	76	-
Total gross deferred tax assets	1,375	1,687
Less valuation allowance	-	-
Net deferred tax assets	$ 1,197	$ 1,335

The reconciliation of the federal statutory income tax rate to the effective tax rate is as follows:

	April 30, 2015	April 30, 2014
Statutory federal income tax rate (benefit) expense, net of noncontrolling interest	34.0%	34.0%
State income tax net of federal benefits	0.0%	0.0%
Permanent tax	59.15%	26.9%
Other	(9.71)%	(38.0)%
	83.44%	22.9%

Income tax expense:		
Deferred income tax (benefit)	$ 138	$ (33)
Current income tax (benefit)	-	66

Total income tax expense (benefit) $138 $33

Current income tax expense (benefit) of $0 and $66 are comprised of $0 and $66 in federal income tax and $0 and $0 in state income tax for the years ended April 30, 2015 and 2014, respectively.

The Company has accrued (refundable) income taxes due to federal and state taxing authorities of approximately $0 and $0 for the years ended April 30, 2015 and 2014, respectively.

The Company believes that its income tax filing positions and deductions will be sustained on audit and does not anticipate any adjustments that will result in a material adverse effect on its financial condition, results of operations or cashflow. Therefore, no reserve for uncertain income tax position, interest or penalties, have been recorded.

The Company files income tax returns in the U.S. Federal jurisdiction and various state jurisdictions. The Company is no longer subject to U.S. Federal tax examinations for tax years beginning on May 1, 2010 and prior. There are no current tax examinations.

4. STOCKHOLDERS' EQUITY:

Common Stock Transactions

During the year ended April 30, 2015, we issued 1,367,006 shares valued at $219 as the match to the Company 401(k) plan.

During the year ended April 30, 2014, we issued 1,873,919 shares valued at $244 as the match to the Company 401(k) plan.

During the year ended April 30, 2013, we issued 1,476,259 shares valued at $281 as the match to the Company 401(k) plan.

During the year ended April 30, 2013, we issued - shares of Company common stock at a value of $90 for marketing and consulting services.

5. STOCK OPTIONS AND INCENTIVE PLANS

The following represents the outstanding and exercisable number of shares, weighted average exercise price and weighted average remaining contractual life of options outstanding and exercisable.

We issued 7,262,064 stock options on December 31, 2010 expiring on December 31, 2015. The exercise price for the incentive stock options is $0.49 (closing price as of December 31, 2010). The incentive stock options are allocated in three groups with two conditions for vesting. The first condition is stock price and the second condition is time:

Year 1: Target $0.92
- 2,420,688 options that can be exercised after December 31, 2011 once the share price reaches $0.92

Year 2: Target $1.41
- 2,420,688 options that can be exercised after December 31, 2012 once the share price reaches $1.41

Year 3: Target $1.90
- 2,420,688 options that can be exercised after December 31, 2013 once the share price reaches $1.90

We used the Black-Scholes model to value the options and used assumptions of ultimately how many option shares would vest based on our experience. The value of the option shares is $684 and has been expensed over the vesting term using active employment to determine monthly expense. For the fiscal year ended April 30, 2015 and April 30, 2014 we expensed $0 and $22, respectively. The fair value of the option shares used the following weighted average assumptions: Strike Price $1.36; Stock Price $0.49; Volatility 125%; Term 3.1 years; Dividend yield 0% and Interest Rate 1.01%.

A summary of stock options and warrants is as follows:

	2015	2014	2013
Options exercisable at April 30	0	0	0
Weighted average fair value per share options granted per year	$0.49	$0.49	$0.49

Range of Exercise Prices	Number Outstanding and Exercisable	Weighted Average Remaining Contract Life	Weighted Average Exercise and Outstanding Price
$ 0.49	0	.7 years	$ 0.49

	Options	Average Price
Outstanding beginning 04/30/2012	7,262,064	$ 0.49
Expired	-	-
Expired	-	-
Exercised	-	-
Outstanding ending 04/30/2013	7,262,064	$ 0.49
Outstanding beginning 04/30/2013	7,262,064	$ 0.49
Granted	-	-
Expired	-	-
Exercised	-	-
Outstanding ending 04/30/2014	7,262,064	$ 0.49
Outstanding beginning 04/30/2014	7,262,064	$ 0.49
Granted	-	-
Expired	-	-
Exercised	-	-
Outstanding ending 04/30/2015	7,262,064	$ 0.49

6. COMMITMENTS:

Lease and Rent Commitments (in thousands).

We lease and rent space with initial terms of three (3) years, (5) years, ten (10) years, and twenty five (25) years. Total rental expense incurred for the years ended April 30, 2015, 2014, and 2013, was $5,030, $4,983 and $5,012 respectively.

Minimum lease and rent agreement commitments under noncancellable operating leases and rental agreements for the next five (5) years are as follows:

Year Ending April 30	Amount
2016	$4,995
2017	4,971
2018	4,978
2019	4,929
2020	4,946
	$24,819

7. CONTINGENCIES:

BHCMC and BHC Development filed a complaint against Bally Gaming in the United States District Court for the District of Kansas in June 2012. After hearing the evidence, in March 2014 the jury rendered a verdict in favor of BHCMC and BHC Development in the amount of $1,424. Bally appealed the verdict. In February of 2015, BHCMC and BHC Development agreed to accept the sum of $1,324 in satisfaction of the judgment. This amount was received in February 2015. BHCMC and BHC Development agreed to return to Bally its system-related equipment which had a book value of $591, resulting in a gain on settlement of $733.

8. RELATED-PARTY TRANSACTIONS:

In the normal course of business we purchased business system components of $4, $50, and $47 from ISG, the employer of Bradley Hoffman, a director of Butler National Corporation during fiscal 2015, 2014 and 2013 respectively.

We paid consulting fees of $135, $135, and $135 to David Hayden, a director of Butler National Corporation in fiscal year ended April 30, 2015, 2014, and 2013, respectively.

Included in accrued liabilities are $209 and $119 as of April 30, 2015 and 2014 respectively for amounts owed to our CEO for accrued compensation.

Included in accounts receivable at April 30, 2015 and 2014 is $780 owed to us by the noncontrolling company of BHCMC, LLC for costs incurred on their behalf.

In fiscal 2015, there were three related-person transactions under the relevant standards: Butler National employed the brother (Wayne Stewart), son (Craig Stewart) and son-in-law (Jeff Shinkle) of Clark D. Stewart, an executive officer, as an engineer, Vice President and Chief Financial Officer, and an architect. Compensation for these related-persons was calculated in the same manner as the Summary Compensation table resulting in compensation of $219, $286 and $179, respectively, for fiscal 2015, $204, $256, and $171, respectively, for fiscal 2014, and $209, $264, and $173 respectively, for fiscal 2013.

The policies and procedures for payment of goods and services for related transactions follow our normal course of business standards and require the necessary review and approval process as outlined in our Policies and Procedures manual and as set forth by our Compensation Committee.

9. 401(k) SAVINGS PLAN

We have a defined contribution plan authorized under Section 401(k) of the Internal Revenue Code. All benefits-eligible employees with at least thirty days of service are eligible to participate in the plan; however there are only two entry dates per calendar year. The Plan may match subject to the annual approval of the Board of Directors, 100 percent of every pre-tax dollar an employee contributes up to 6% of the employee's salary. Employees are 100 percent vested in the employer's contributions immediately. Our matching contribution, as approved by the Board of Directors was paid in common stock of the Company. The contribution amount was valued at the market price of the stock contributed in 2015, 2014, and 2013 was approximately $219, $244, and $281 respectively

10. INDUSTRY SEGMENTATION AND SALES BY MAJOR CUSTOMER:

Industry Segmentation

Current Activities - The Company focuses on two primary activities, Professional Services and Aerospace Products.

Aerospace Products:

Aircraft Modifications principally includes the modification of customer and company owned business-size aircraft from passenger to freighter configuration, addition of aerial photography capability, and stability enhancing modifications for Learjet, Beechcraft, Cessna, and Dassault Falcon aircraft along with other specialized modifications. We provide these services through our subsidiary, Avcon Industries, Inc. ("Aircraft Modifications" or "Avcon").

Avionics principally includes the manufacture, sale, and service of airborne electronic switching units used in DC-9, DC-10, DC-9/80, MD-80, MD-90, and the KC-10 aircraft, Transient Suppression Devices (TSDs) for fuel tank protection on Boeing Classic 737 and 747 aircraft, and other Classic aircraft using a capacitance fuel quantity indicating system ("FQIS"), airborne electronics upgrades for classic weapon control systems used on military aircraft and vehicles, and consulting services with airlines and equipment manufacturers regarding fuel system safety requirements. We provide the products through our subsidiary, Butler National Corporation - Tempe, Arizona and the services through Butler National Corporation - Olathe, Kansas ("Avionics", "Classic Aviation Products", "Safety Products", or "Switching Units").

In September 2010 we expanded this division by the acquisition of Kings Avionics, Inc., now known as Butler Avionics, Inc. The acquisition of Butler Avionics allowed us to transition into the new technology available in avionics. Butler Avionics sells, installs and repairs avionics equipment (airplane radio equipment and flight control systems). These systems are flight display systems which include intuitive touchscreen controls with large display to give users unprecedented access to high-resolution terrain mapping, graphical flight planning, geo-referenced charting, traffic display, satellite weather and much more. Butler Avionics is also recognized nationwide for its troubleshooting and repair work particularly on autopilot systems.

Professional Services:

BCS Design, Inc. provides licensed architectural services. These services include commercial and industrial building design.

Butler National Service Corporation ("BNSC") provides management services to the Boot Hill Casino, a "state-owned casino" and to The Stables, an "Indian-owned casino".

Year ended April 30, 2015	Professional Services	Aerospace Products	Consolidated
Total revenues	$ 30,795	$ 16,267	$ 47,062
Depreciation and amortization	1,573	1,312	2,885
Operating income (loss)	1,794	(475)	1,319
Capital expenditures, net	420	3,262	3,682
Interest expense	-	-	(1,141)
Other income (expense)	-	-	16
Income (loss) before taxes	-	-	967
Income tax expense (benefit)	-	-	138
Net income (loss) attributable to Butler National Corporation	-	-	27
Identifiable assets, net	21,650	19,948	41,598

Year ended April 30, 2014	Professional Services	Aerospace Products	Consolidated
Total revenues	$ 31,022	$ 16,249	$ 47,271
Depreciation and amortization	1,676	1,819	3,495
Operating income (loss)	1,819	102	1,921
Capital expenditures, net	148	142	290
Interest expense	-	-	(1,417)
Other income (expense)	-	-	43
Income (loss) before taxes	-	-	547
Income tax expense (benefit)	-	-	33
Net income (loss) attributable to Butler National Corporation	-	-	112
Identifiable assets, net	22,091	19,587	41,678

Year ended April 30, 2013	Professional Services	Aerospace Products	Consolidated
Total revenues	$ 35,525	$ 13,627	$ 49,152
Depreciation and amortization	1,285	1,991	3,276
Operating income (loss)	2,987	(1,484)	1,503
Capital expenditures, net	7,180	979	8,159
Interest expense	-	-	(1,521)
Other income (expense)	-	-	11
Income (loss) before taxes	-	-	(7)
Income tax expense (benefit)	-	-	(816)
Net income (loss) attributable to Butler National Corporation	-	-	(148)
Identifiable assets, net	23,880	19,980	43,860

Major Customers: Revenue from major customers (10 percent or more of consolidated revenue) were as follows:

	2015	2014	2013
Modifications	N/A *	N/A *	N/A *
Avionics	N/A *	N/A *	N/A *
Management services	N/A *	N/A *	N/A *
Environmental services	N/A *	N/A *	N/A *

*Revenue represented less than 10% of consolidated revenue.

In fiscal 2015 the Company derived 18.7% of total sales from five customers. The top customer provided 5.8% of total sales while the next top four customers ranged from 1.3% to 4.6%.

11. FAIR VALUE MEASUREMENTS

The Company adopted ASC Topic 820-10 at the beginning of 2009 to measure the fair value of certain of its financial assets required to be measured on a recurring basis. The adoption of ASC Topic 820-10 did not impact the Company's financial condition or results of operations. ASC Topic 820-10 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). ASC Topic 820-10 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date. A fair value measurement assumes that the transaction to sell the asset or transfer the liability occurs in the principal market for the asset or liability. The three levels of the fair value hierarchy under ASC Topic 820-10 are described below:

Level 1 - Valuations based on quoted prices in active markets for identical assets or liabilities that an entity has the ability to access.

Level 2 - Valuations based on quoted prices for similar assets and liabilities in active markets, quoted prices for identical assets and liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of the assets or liabilities.

Level 3 - Valuations based on inputs that are supportable by little or no market activity and that are significant to the fair value of the asset or liability.

The following table presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis as of April 30, 2015 (in thousands):

	Level 1	Level 2	Level 3	Fair Value
Promissory notes	$ -	$ -	$1,510	$1,510
Long-term debt	-	-	9,282	9,282
	$ -	$ -	$10,792	$10,792

The following table presents a reconciliation of all assets and liabilities measured at fair value on a recurring basis as of April 30, 2014 (in thousands):

	Level 1	Level 2	Level 3	Fair Value
Promissory notes	$ -	$ -	$1,757	$1,757
Long-term debt	-	-	10,728	10,728
	$ -	$ -	$12,485	$12,485

12. SUBSEQUENT EVENTS

The Company evaluated its April 30, 2015 financial statements for subsequent events through July 29, 2015, the filing date of this report. The Company is not aware of any subsequent events that would require recognition or disclosure in the financial statements.

13. SUMMARY OF QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

The following table sets forth selected unaudited financial information for each quarter of fiscal 2015, 2014, and 2013 (in thousands, except per share amounts).

2015	First	Second	Third	Fourth	Total
Revenues	$12,391	$11,752	$11,083	$11,836	$47,062
Operating income (loss)	806	367	535	(389)	1,319
Non-operating income (expense)	(286)	(300)	(246)	480	(352)
Net income (loss) attributable to Butler National Corporation	252	29	68	(322)	27
Basic earnings (loss) per share*	.00	.00	.00	(.01)	.00
Diluted earnings (loss) per share*	.00	.00	.00	(.01)	.00

*Rounded to nearest hundredth

2014	First	Second	Third	Fourth	Total
Revenues	$10,996	$10,799	$10,844	$14,632	$47,271
Operating income (loss)	143	(198)	18	1,958	1,921
Non-operating income (expense)	(352)	(360)	(346)	(316)	(1,374)
Net income (loss) attributable to Butler National Corporation	(289)	(345)	(219)	965	112
Basic earnings (loss) per share*	.00	(.01)	.00	.02	.00
Diluted earnings (loss) per share*	.00	(.01)	.00	.02	.00

*Rounded to nearest hundredth

2013	First	Second	Third	Fourth	Total
Revenues	$13,023	$13,152	$10,651	$12,326	$49,152
Operating income (loss)	1,285	700	(520)	38	1,503
Non-operating income (expense)	(337)	(331)	(417)	(425)	(1,510)
Net income (loss) attributable to Butler National Corporation	268	114	(755)	225	(148)
Basic earnings (loss) per share*	.00	.00	(.01)	.00	.00
Diluted earnings (loss) per share*	.00	.00	(.01)	.00	.00

*Rounded to nearest hundredth

The individual quarter and fiscal year earnings per share are presented as shown in our quarterly and annual filings with the Securities and Exchange Commission. These numbers are rounded up to the nearest tenth.