IFS_4Q19
Earnings Conference Call - Transcript

Operator: Good morning and welcome to the Intercorp Financial Services Fourth Quarter 2019 Conference Call. All lines have been placed on mute to prevent any background noise. After the presentation, we will open the floor for questions. At that time instructions would be given as to the procedure to follow if you would like to ask a question.

It's now my pleasure to turn the call over to Rafael Borja of i-advize corporate communications. Sir, please go ahead.

Rafael Borja: Thank you, and good morning, everyone. On today's call, Intercorp Financial Services will discuss its Fourth Quarter 2019 earnings. We are very pleased to have with us Mr. Luis Felipe Castellanos, Chief Executive Officer, Intercorp Financial Services; Ms. Michela Casassa, Chief Financial Officer, Intercorp Financial Services; Mr. Juan Pablo Segura, Chief Financial Officer, Interseguro, and Mr. Bruno Ferreccio, Chief Executive Officer, Inteligo. They will be discussing the results that were distributed by the company yesterday.

There is also a presentation to accompany these results. If you didn't receive a copy of the presentation or the earnings, they are now available on the company's website, ifs.com.pe, to download a copy. Otherwise, for any reason, if you need any assistance today, please call i-advize New York at (212) 406-3693.

I would like to remind you that today's call is for investors and analysts only. Therefore, questions from the media will not be taken. Please be advised that forward-looking statements may be made during this conference call. These do not account for future economic circumstances, industry conditions, the company's performance or financial results. As such, statements made are based on several assumptions and factors that could change causing actual results to materially differ from the current expectations. For a complete note on forward-looking statements, please refer to the quarterly report issued yesterday.

It is now my pleasure to turn the call over to Mr. Luis Felipe Castellanos, Chief Executive Officer of Intercorp Financial Services for his presentation. Mr. Castellanos, please go ahead.

Luis Felipe C.: Thank you, and good morning, everyone. Welcome to IFS' Fourth-Quarter and Year-end 2019 Earnings Call. I'm going to give you a brief overview of the situation. Let's start with the macro environment.

The Peruvian economy has proven to be very resilient. Despite the well-documented political volatility that the country continues to undergo and a deteriorating external environment, Peru's GDP continues to grow, although on a more moderate pace than the country's potential suggests. We believe that this is the result of the macro discipline and sound foundations that support Peru's macro framework. As a result, GDP for 2019 will come at around 2 percent, with the expectation of a slight recovery in 2020 hitting the 3 percent-plus mark.

As we see it, the acceleration of growth for this year will be supported by sustained domestic demand and a recovery in primary sectors, as well as by the expectation of higher and more efficient public spending. Inflation remains under control and FX dynamics remain stable. Now let's talk about our financial sector in Peru, which once again had a strong year. At the banking system, loans grew almost 6 percent in 2019, driven by increases of 11 percent in retail loans and 3 percent in commercial loans.

Deposits also increased, reaching an 8 percent year-over-year expansion. The banking system continued to be profitable, with earnings growing north of 10 percent system wide and ROE for the system at around 18 percent. The system continues to be well capitalized with total capital ratio of 14.6 percent as of year-end. Similarly, the insurance sector had a very solid year, which saw a 10 percent growth in total assets, with total premiums growing 7 percent year over year.

Under this environment, IFS had a very solid performance during the year, with a particular strong performance in the 4Q. All in all, 2019 was a record year for IFS, with total earnings reaching PEN 1,450 million. Interbank continue to increase its market share in loans and deposits.

We have consolidated our leadership as the No.1 player in consumer credit cards, remain as the second main player in other consumer loans and have outpaced the industry growth in all the products where we have a strategic focus, including credit cards, mortgages, consumer loans and retail deposits. Our commercial banking franchise continues to expand in a sustainable and profitable way. Our efficiency levels continue to improve, and the bank remains well provisioned and well capitalized. Interbank reached a 21 percent growth in adjusted earnings and a 21 percent adjusted ROE.

Our digital transformation efforts continue to deliver promising results. Digital usage and engagement continue to improve as more capabilities are being deployed for the benefit of our customers. Interseguro reached record earnings with ROE under IFRS at 14 percent, resuming growth in annuities, where it remains as a market leader and continues to deploy new products within the life insurance spectrum. Inteligo continues to grow in assets under management and has achieved good levels of profitability during the year, with ROE topping 25 percent.

As you can see, our strategic focus and our disciplined approach to build in our strengths by operating in a market that continues to provide significant growth opportunities has enabled us to render solid results during the year. As you know, last year, we had the opportunity to do our international IPO in the New York Stock Exchange, incorporating over 80 new investors, increasing our float and also positively impacting the trading level of IFS shares. Trading volume has increased almost threefold since the transaction, positively impacting the liquidity of our stock. In 2019, our companies were awarded with several recognitions.

Interbank was selected as the best company to work for in Peru, according to the Great Place to Work Institute, as well as the second-best place to work for women and the sixth best company to work for millennials. Likewise, Inteligo SAB and Interseguro were awarded with the second and sixth best places to work for in their respective categories. These recognitions come hand in hand with our strategy of attracting, developing and retaining highly qualified talent and creating a merit-based culture that emphasizes teamwork and values. Additionally, Interbank was recognized as the Bank of the Year in Peru by The Banker, also recognized as one of the 10 Most Admirable Companies in the country by PricewaterhouseCoopers and La Revista G de Gestión.

Finally, Interbank was also awarded with the second place among the companies with best reputation in Peru, according to a study from Merco. We believe that our well-positioned platform will allow us to continue to take advantage of the growth opportunities that the Peruvian market presents, while positively contributing to the development of the country and the financial well-being of Peruvians. Focus is key. We remain committed to executing our strategy, while continuing our digital transformation efforts for the benefit of our employees and customers.

Now let me pass it on to Michela for a deeper review of our results.

Michela Casassa: Thank you, Luis Felipe. Good morning, everybody. And welcome again to Intercorp Financial Services fourth-quarter and full-year 2019 earnings call. Under the environment that Luis Felipe has just described, we believe that IFS has had a very strong performance, both in the fourth quarter and during the full-year 2019.

Let me start the discussion with an overview of IFS' performance on Slide 1, 2 and 3. At IFS, strong earnings growth year on year, with adjusted ROE at 18.6 percent. Full-year adjusted net profit grew 19.7 percent year over year. IFS' annual profit reached a record figure of PEN 1.5 billion in 2019, with a 10.6 percent increase in total revenues year over year, with an improvement in the efficiency ratio of 60 basis points, down to 34 percent.

Strong performance on all three operating segments and continued positive evolution of our digital indicators. At Interbank, strong core growth and profitability, especially in retail. Full-year '19 adjusted net profit grew 21.2 percent year over year with adjusted ROE at 21.3 percent, 11.2 percent year over year loan growth with a 17.5 percent increase in retail loans, outpacing the system. Retail deposits grew 11.5 percent year over year, resulting in 50 basis points market share growth.

Strong revenue generation year over year, with net interest income growing 11.7 percent and fee income growing 8.9 percent. Full-year reported cost of risk remained stable at a low level of 2.2 percent, which includes a release of provisions, both in the second and in the fourth quarter due to a better risk profile of the portfolio. Full-year adjusted cost of risk increased 10 basis points year over year to 2.6 percent. Core equity Tier 1 improved 100 basis points in the year to 11.6 percent.

At Interseguro, profitability continued to improve, with full-year ROE at 14.2 percent and fourth-quarter ROE at 14.7 percent. Full-year adjusted net profit grew 56.5 percent year over year, 6.9

percent growth in gross premiums plus collections. Return over investment portfolio increased 30 basis points to 6.1 percent in 2019 and 10.7 percent growth in the investment portfolio. At Inteligo, solid year in earnings, with ROE at 25.3 percent; adjusted net profit, up 4.1 percent year over year; increase in assets under management in the year of 4.3 percent or 6.1 percent, excluding FX effect; strong growth in fees for the second consecutive quarter; and improved market conditions by year-end.

On Slides 4 and 5, let's have a closer look at the quarterly performance. IFS registered earnings of PEN 413 million in the fourth quarter and PEN 442 million when excluding the one-off impact of a Liability Management transaction at Interbank performed between October and November to improve the funding structure and cost of funds, which we will describe later on in the presentation. This led to a quarterly ROE of 20.3 percent for IFS. It is worth mentioning that during the quarter and due to an update of the IFRS 9 provision model, there has been a release of provisions of PEN 73.4 million after tax, which is the result of the improvement in the risk profile of the portfolio.

As mentioned during the previous quarterly call, after two years of implementation of IFRS 9, we have been able to better tailor our predictive models to more accurately estimate future cost of risk or expected loss, which resulted in a first release of provisions in the second quarter and in this second one during the fourth quarter. These new estimates better reflect our real cost of risk, which is lower than what we initially estimated at the time of the first implementation back in 2018. All three operating segments had strong performances during the fourth quarter, with strong increases in the quarterly and yearly earnings and high ROEs. Interbank posted PEN 337 million earnings, or PEN 366 million when excluding the Liability Management transaction, and a 23.6 percent ROE in the quarter.

Second, Interseguro posted PEN 35 million and a 14.7 percent ROE, while Inteligo posted PEN 70 million earnings and a 34.1 percent ROE during the quarter. Total revenues accelerated growth reaching 5.2 percent in the quarter and 13.8 percent when compared to the same quarter last year. A positive trend also for net interest and similar income, with growth of 2.6 percent in the quarter and 11.1 percent when compared to the same quarter last year. Efficiency ratio furtherly improved in the quarter, down to 33.1 percent.

At Interbank, efficiency ratio had a strong improvement in the quarter, down to 37.7 percent, as costs remain relatively stable on a quarterly basis, while revenues continue to increase nicely in the quarter. NIM at Interbank remained stable in the quarter and increased 10 basis points in the year. Reported risk-adjusted NIM showed a strong improvement due to the release of provisions previously mentioned, with adjusted NIM after provisions at 3.8 percent. Fees continue to grow nicely at the bank at 3 percent in the quarter.

Total capital ratio for Interbank stands at 15.2 percent, with core equity Tier 1 ratio up 20 basis points in the quarter to 11.6 percent. At the insurance segment, gross premiums plus collections decreased 5.3 percent in the quarter and 10.9 percent in the year, mainly due to a market contraction and to aggressive competition on rates in the annuities business, which has been partially offset by growth in the life insurance business and in the retail insurance business. Yearly figures show a 6.9 percent growth in gross premiums plus collections. Return on investments in the insurance portfolio decreased 30 basis points in the quarter and is flat versus the fourth quarter of the previous year, mainly due to mark to market of the portfolio.

At our wealth management segment, assets under management grew 3.5 percent in the quarter and 6.1 percent in the year. Fee generation continues to be strong, growing 13.8 percent in the quarter and 13 percent in the year.

On Slide 6, IFS relevant net income, which is the base for dividend payments, grew 17.8 percent when compared to the same period last year, which included extraordinary gains at Interseguro after the completion of the merger with Sura at that time. Interbank registered PEN 1.2 billion earnings; Interseguro, PEN 436 million, due to very strong results in local GAAP; and Inteligo, PEN 200 million.

On Slides 7 and 8, we continue to see a positive evolution of our digital indicators. Digital users, which include customers who interact with the bank through our digital platform over the number of customers who have touched the bank in the last three months, has reached 63 percent in December 2019, up 53 percent from December 2018, representing a 43 percent increase year over year in the number of digital users. As of the end of December 2019, digital users amounted to 1.2 million clients. 100 percent digital customers, who are customers that do not use branches or contact center any longer, is at 25 percent as of December, compared to 21 percent one year before.

The percentage of total transactions performed away from branches has increased 1 percentage point to 96 percent, with a higher participation of Internet and mobile transactions at 79 percent from 76 percent one year ago. Digital sales reached 42 percent as of December 2019, up from 31 percent one year before. And digital acquisition of retail customers has continued to grow from 8 percent of new retail customers in December 2018 to 28 percent in December 2019. On Slide 8, saving accounts opened digitally reached 34 percent in December, compared to 16 percent one year before, while business accounts or Cuenta Negocios opened digitally reached 62 percent, up from 41 percent one year before.

Extra cash loans sold digitally reached 19 percent, up from 12 percent, and SOAT car insurance policies sold digitally reached 70 percent, compared to 58 percent one year ago. Moreover, during the last quarter of 2019, together with BBVA and Scotiabank, we have launched PLIN, instant bank-to-bank transfers, contact transfers using cellphone contact numbers, which has a potential customer base of more than 10 million. Now let's have a look at each segment's performance in detail.

On Slide 10, core revenues growth drives improvements in efficiency ratio at Interbank. You can see improvements in most of the key indicators. NIM remained stable in the quarter and improved 10 basis points in the year, reaching 5.8 percent, while risk-adjusted NIM improved 10 basis points in the year, up to 3.8 percent. Total other income continued to grow strongly at 4.8 percent in the quarter and 13.8 percent when compared to the same quarter one year before, with fee income growing nicely at 3 percent in the quarter and 5.2 percent year over year.

The increase in fee income is mainly due to the strong increase in credit card fees related to the increasing usage and number of merchants, which is partially offset by other decreasing fees related to the migration to digital channels and to lower activity in contingent credits and corporate finance.

Other expenses remained flat in the quarter and only grew 3.5 percent year over year, with a strong improvement on the efficiency ratio, which reached 37.7 percent in the quarter due to the operating leverage we continue to register at the bank, with total revenues growing faster than expenses.

During the fourth quarter, we have decreased nine additional branches, totaling a reduction of 35 branches since 2015 or 12 percent of the total branch network, down to 255 branches as of December 2019. During 2020, we will continue our efforts to make our omnichannel platform one of the best and most productive.

On Slide 11, our year-over-year loan growth reached 11.2 percent, with retail loans growing 15.8 percent and commercial loans growing 6 percent. We continue to grow faster than the market at 3.3 percent during the quarter, compared to the 2.3 percent of the banking system, with retail growing at 3.2 percent quarter over quarter and commercial banking, 3.5 percent. During the year, we have achieved the No. 1 position in credit cards, with a 27.1 percent market share as of December.

And during the last quarter, we have also become the second retail bank in the country, with a 19 percent market share. And we have reached the No. 3 position in mortgages, with a 14.7 percent market share. Our market share in total retail loans increased 10 basis points on a quarterly basis and increased 10 basis points in commercial loans, up to 8.9 percent, leading to an increase of 10 basis points in the total loans market share, which reached 12.6 percent.

With this, the yearly growth in market shares was 250 basis points for credit cards, 50 basis points for mortgages, 80 basis points in total retail loans, 20 basis points in commercial loans and 60 basis points in total loans.

On Slide 12, retail deposits continue to grow nicely, reaching 11.5 percent year over year, allowing us to gain 50 basis points of market share in the last 12 months, reaching a record 13.5 percent. Total deposits grew 5.4 percent quarter over quarter as the result of an increase of 4.3 percent in retail deposits and 6.4 percent in commercial deposits.

Decrease in bonds was mainly explained by the closure of the liability management transactions performed between October and November, resulting in two new bonds: one for PEN 312 million and one for US$ 400 million, both due in October 2026, which replaced our 5.75 percent senior notes due 2020 corporate bonds.

This Liability Management transaction generated a one-off negative effect of around $9 million, which is reported in the fourth-quarter figures, but which, at the same time, will help us improve our cost of funds going forward as we have replaced a 5.75 percent coupon bond, with a 3.25 percent coupon bond in dollars.

Average cost of funds has already improved 10 basis points in the quarter, down to 2.8 percent, but the full effect will be reflected in the following quarters. Loan-to-deposit ratio at 101.6 percent, well below the system's average of 106 percent as of year-end. On Slide 13, we are showing the evolution of the stock of provisions over total exposure or expected loss.

This trend shows that the risk profile of the bank has been improving over the past two years since the first implementation of IFRS 9 and despite some quarter volatility in cost of risk. Moreover, with the update of the models previously mentioned, it has furtherly improved down to 3.5 percent expected loss from 4.2 percent in the first quarter of 2018.

On Slides 14 and 15, annual cost of risk was stable, both reported and adjusted figures at 2.2 percent and 2.6 percent, respectively. The quarterly reported figure of 1.7 percent is particularly low due to the release in provisions previously mentioned, which had stronger impacts on commercial loans and consumer loans.

The adjusted figure, which excludes the full release, is at 2.8 percent in the quarter. And we believe cost of risk will be below that figure in the coming quarter, using the full update of the models. The nonperforming exposure under IFRS criteria improved, both during the quarter and when compared to the previous year. When looking at Stage 2 and 3 over total exposure, the ratio improved 60 basis points this quarter and 270 basis points year over year, down to 8.9 percent.

This means that over 90 percent of the bank's total exposure sits now on fully performing Stage 1 IFRS classification. When looking at Stage 3 and refinanced loans, this ratio was 2.9 percent as of December, a 10 basis points decrease in the quarter. The total nonperforming loan coverage ratio, which measures the coverage of Stage 3 and refinanced loans, remains strong at 117.7 percent, with retail NPL coverage at 135 percent, credit card NPL coverage at 186 percent and commercial NPL coverage at 73 percent.

On Slide 16, Interbank's capital ratio of 15.2 percent is 360 basis points above its risk-adjusted minimum requirement established at 11.6 percent and above the system average of 14.6 percent.

Core equity Tier 1 ratio has strengthened 20 basis points in the quarter and 100 basis points in the year, reaching a record 11.6 percent despite the strong growth registered in the past 12 months in loans and in risk-weighted assets.

Please turn to the following pages to discuss our insurance segment results. On Page 18, gross premiums increased 6.9 percent on a yearly basis, with growth in all business segments. Interseguro remains market leader in annuities, with a 28.9 percent market share.

During the fourth quarter, gross premiums decreased 5.3 percent on a quarterly basis and 10.9 percent on a yearly basis, excluding Seguros Sura's gross premiums from disability and survivorship contract that expired in December 2018. Growth in individual life and retail insurance was offset by a market contraction in private annuities and competitive pricing challenges in the regulated market for both quarterly and yearly performance, which we currently see normalizing.

On Slide 19, in the fourth quarter, Interseguro investment portfolio reached PEN 12.4 billion, which represents an increase of 1.1 percent in the quarter and 10.7 percent in the year. Results from investments in the fourth quarter were PEN 184 million, which represented a 6 percent return on Interseguro's investment portfolio, down 30 basis points during the quarter but stable versus the last quarter of 2018 despite negative mark to market in the fourth quarter of 2019.

Please turn to the following pages to discuss our wealth management segment results. On Page 21, Inteligo's net interest and similar income was PEN 24.7 million in the fourth quarter, a 6.9 percent decrease when compared to the third-quarter 2019. This was mainly explained by lower interest income associated with the reduced treasury portfolio. On the other side, net fee income from financial services was PEN 47 million, an increase of 13.8 percent on a quarterly basis.

Net fee income from financial services increased 13 percent when looking at the yearly comparison. Growth in fee income was mainly explained by rebalancing activities implemented in client portfolios throughout the year, portfolio implementation strategies for new client funds and brokerage fees generated by go-to-market operations.

Fee income divided by assets under management increased to 1.0 percent. Inteligo's other income reached PEN 30 million in the fourth quarter, an increase of PEN 39 million on a quarterly basis and PEN 25.5 million on a yearly basis, attributable to positive mark-to-market valuation on Inteligo's proprietary portfolio during the fourth quarter.

In sum, revenues generated by Inteligo were PEN 101.7 million, an increase of 74 percent on a quarterly basis and 35 percent on a yearly basis. Excluding the positive impact of mark-to-market valuation, total revenues would have been PEN 69.2 million.

On Slide 22, Inteligo's assets under management reached PEN 18.3 billion in the fourth quarter, a 1.4 percent increase on a quarterly basis and 4.3 percent year over year, mostly due to new account openings resulting from strengthened prospection and client conversion strategies. Inteligo's loan portfolio reached PEN 1.6 billion, a 3.5 percent increase in a quarterly basis and 3.1 percent year over year.

Other expenses reached PEN 31.8 million in the fourth quarter, excluding asset amortization from Interfondos acquisition for PEN 1.3 million, an increase of 4.1 percent on a quarterly basis and 10.9 percent on a yearly basis. Inteligo's net profit and ROE were PEN 70 million and 33.6 percent, respectively. Excluding asset amortization from Interfondos acquisition, Inteligo's ROE would have stood at 34.1 percent in the quarter. Now let's have a look at our guidance for 2020.

In terms of ROE, we expect IFS to be in the range of 17 percent to 19 percent, the bank at 18 percent to 20 percent, Interseguro at around 15 percent and Inteligo at around 25 percent. Additionally, banking system loan growth should be at around 7 percent for the year, which is slightly higher than the 5.5 percent registered during 2019, with the expectation of a slight recovery in the commercial banking system growth.

We are foreseeing our loan growth to be in the low double-digit level, a similar guidance to the one we gave last year in which we ended up growing 11.2 percent, with a higher growth of retail versus commercial banking. NIM should slightly improve from the 5.7 percent registered during 2019 to a range of 5.7 percent to 5.9 percent.

A reduction in cost of funds coming from both the Liability Management transaction done in 2019 and a decrease in rates should support this improvement. Guidance of cost of risk at 2.4 percent to 2.7 percent is lower to what we gave last year of 2.5 percent to 3 percent, mainly due to the improved risk profile of the overall banking portfolio. Adjusted cost of risk for 2019 was 2.6 percent, while the reported one was 2.2 percent, which included some releases of provisions, as previously mentioned. With this, NIM after provisions should improve to a range of 4 percent to 4.2 percent.

Our operating leverage should continue helping efficiency ratio. Efficiency ratio guidance is to be below 40 percent for 2020.

Finally, our guidance for core equity Tier 1 is to be not below 10 percent. Thank you very much.

As you have seen from the numbers, our core business trends continue to be very strong. We are committed to executing our strategic plan with a strong emphasis in our digital transformation for the benefit of our customers, and we are starting a new year with this view. Now we welcome any questions you may have.

Operator: [Operator instructions] And we'll take our first question from Andres Soto with Santander. Please go ahead.

Andres Soto: Good morning, Michela and Luis Felipe. Thank you for the presentation. My question is related to your guidance in terms of loan growth. I see you're expecting a significant superior growth compared to the system.

So, I would like to understand what is driving this outlook? What are the segments where you are expecting to grow? And which ones you are expecting to gain some market share? Thank you.

Michela Casassa: Hello. Thank you for your question. In terms of loan growth, we see trends similar to what we have experienced during 2019. So basically, we expect retail loans to continue to grow double digit, with credit cards now growing double digits, mortgage loans growing double digit, as well as consumer loans.

Basically, if you see the performance of most of those products, we have been consistently gaining market share in those products, and we expect to continue to do so in the future. That's with regards to the retail portfolio. In terms of the commercial portfolio, again, here, last year, we grew single digit because the market also grew very little there. But in any case, we gained market share in most of the segments in commercial banking.

What we are expecting for 2020 is to gain market share, especially in the mid- and small business market and to continue to be focused on profitability on the large corporate segment where we will continue to assess opportunities on a case-by-case basis but always looking at profitability and not necessarily to size.

Andres Soto: Perfect. Thank you

Operator: Thank you. We'll take our next question from Ernesto Gabilondo with Bank of America. Please go ahead.

Ernesto Gabilondo: Felipe and Michela, good morning, everyone. Congratulations on your results. So, as you have mentioned, the quarter has two one-offs. One, the redemption of the senior notes, and the other one, the release of provision charges.

If we exclude them, net income came, as you pointed out, with double-digit growth. So, I believe your guidance assumes the normalization of both one-offs in NIMs and cost of risks. However, what is troubling us is that the IFRS ROE guidance seems to be very ample. It's between 17 percent and 19 percent.

And according to our numbers, this implies net income growth of 1 percent to 14 percent. So, the middle range of a 19 percent ROE is equivalent to 8 percent earnings growth. So, I will appreciate what part of the range are you seeing more comfortable to deliver? And what could be the risks or drivers in your guidance? Is it competition, economic growth, the presidential elections next year? Any color on this will be very helpful.

And then my second question is also related to your guidance. We notice that you're expecting ROE improvement in the insurance and wealth management business when compared to 2019. But when we go and see the bank, you're expecting a lower ROE. So, can you elaborate what is behind your expectations? Thank you.

Michela Casassa: Thank you, Ernesto, for your questions. Going to the first one and related to the guidance of the ROE for IFS and earnings growth and how everything adds up together. There is an additional element, Ernesto, to be considered, which is the holding company, okay? Actually, when you see the guidance between 17 percent and 19 percent is not 100 percent correlated to that calculation that you have done in terms of increasing earnings coming from the two operating companies.

There are three other elements within the holding that are impacting this ROE. The first one is the withholding tax that we pay for dividends, okay? As you have seen from the slide that I have shown, the relevant net income from dividend distribution has increased 18 percent, okay? This means that we need to pay 18 percent more taxes, and this is accounted in the holding expenses. So, this is an expense, if you want, that grows faster than whatever other expense that we have in the operating companies. A second one is some expenses that we will incur during 2020 related to the implementation of SOX.

As you know, we are in the middle of this process after the IPO. We have now this full year to finalize a series of improvement in our internal controls for this. And the third element that has created a little bit of volatility in terms of ROE for IFS during the past quarters is the unrealized gains on equity. Bear in mind also that we haven't yet fully deployed the capital that we raised during the IPO.

So that is also impacting a little bit the ROE of IFS. So, if you add up all of these things together, this is what makes us give this broad guidance, which adding everything up together doesn't mean that the earnings of IFS will grow single digit. I mean, we believe we're going to be a little bit more on the low double digits than on a single-digit level.

Ernesto Gabilondo: Now, that's perfect. This clarification of maintaining the low double-digit growth in the earnings, it's very good. Thank you so much.

Michela Casassa: And as far as your second question is concerned, in the guidance of the ROE for the bank, in 2019, we have a 21.3 percent ROE. But this includes the reversal of provisions, okay? If I exclude that impact, ROE would have been at 19.6 percent, okay? So basically, our guidance is between 18 percent and 20 percent, comparing with the 19.6 percent of last year.

Basically, here, I guess, is a little bit of the same. We should be also in similar growth levels in terms of earnings of what we have experienced before and should have no problem to be within this range of guidance for ROE.

Ernesto Gabilondo: That makes sense. Michela, thank you very much.

Michela Casassa: Thank you.

Operator: Thank you. Yuri Fernandes, please go ahead.

Yuri Fernandes: Hi. So, I had a question regarding your change on the risk models on the IFRS model, the one-time benefit you had this quarter. If you can give more color on what's behind it, like, in which segments did you have, like, this revision? If we could expect going movements here, on this? That's the first one.

And my second question is regarding Inteligo. Last quarter, the third quarter was full of variables also, I would say more on the negative side there. I recall you mentioned you had like losses on mark to market regarding, I think, U.S. kind of investments. So, my question, the gain you had this quarter in the first year, this is like the reversal of those losses? And if this volatility should be placed for Inteligo? And also, Inteligo, if you could give more color regarding the assets under management growth.

It's growing around 4 percent year over year. And the operating trend, like, going forward seems a pretty light growth for assets under management. So those are my questions. Thank you.

Michela Casassa: Hi Yuri, good morning and thank you for your questions. Let me start with the first question related to the update of the risk models. Basically, the impact that we've had has been on most of the portfolio, okay? In Slide 13, where I show the expected loss, you can see more directly in commercial loans, where you see that from the third quarter to the fourth quarter, expected loss has decreased from 1.7 percent to 1.3 percent, okay? Also, in retail, there has been an impact, even if you see the ratio stable. The impact in retail is also due to the improvement in the risk profile, but at the same time, there has also been a positive impact on the total exposure. And this is linked to the fact of the calculations we do, for example, with the percentage of the conversion factor with credit cards, etc. So even if the ratio doesn't show, there is also a positive impact there.

So, we have seen improvements in credit cards, in payroll deductible loans, in all commercial loans. So basically, what we believe is that this sets like a new standard. So, the overall improvement in the risk profile is something that is like a new start and that should drive our cost of risk to a lower level next year. This is why we feel comfortable in reducing the range of the guidance of cost of risk and also lowering the lower end of that guidance.

I don't know if that's--

Yuri Fernandes: No, no, no, that's very clear. My concern was that you could see something like risk elements on the other side, like on the negative side. But from -- if I look to the math, like NPL ratio, the NPL transformation, they are looking okay. So not concerned on the asset quality but just to understand a little bit more the moving parts.

Michela Casassa: And related to Inteligo, let me comment a little bit on the volatility of mark to market, and then I will pass it to Bruno. Just to remind you that, since we implemented IFRS 9 at the beginning of 2019, there is a bigger portion of earnings related to the portfolio of Inteligo, of mark to market that goes through P&L. This has created a little bit more of volatility.

This mark to market used to go through equity before. So now this goes through earnings. And what happens is that we have experienced, for example, fourth-quarter 2018, which was a low level. Then it recovered during the first quarter of this year.

Then we had a couple of weak quarters, which were the second and the third. And this has recovered on the fourth quarter. Then when you see the overall full year, the ROE of Inteligo continues to be at 25 percent, so this normalized a little bit. And with this, I will pass it to Bruno for further comment.

Bruno Ferreccio: Yes. So just to complement on what Michela was saying, the first thing is I think it's tough to get a read on the quarter to quarter because of the volatility. But we see this as a 12-month investment horizon or long-term investment horizon, I should say. But on a 12-month rolling basis, the volatility year-to-year dissipates, if you want to call it something, okay? And then in terms of your question regarding if the gains on the fourth quarter were a reversal of the losses on mark to market of the third quarter, the answer is partially yes.

So, some of what we've seen in the fourth quarter was due to markets and prices recovering. But then there was continued price appreciation, so it was more than just recovering some of the losses from the third quarter. With regard to your second question, I believe it was why the AUM growth was only 4 percent. The first thing I should mention is most of our assets under management are denominated in dollars.

Our growth was over 6 percent in dollars. But then when you turn that into soles, there is an FX impact that actually makes that look a little lower. But in terms of growth expectations, we target three times GDP growth on assets under management, and we hope to continue to maintain that level of growth going forward.

Yuri Fernandes: That's nominal GDP or real GDP, the 3x multiplier?

Bruno Ferreccio: Real GDP.

Yuri Fernandes: Thank you Michela and Bruno

Bruno Ferreccio: Thank you Yuri.

Operator: Thank you. Next question, from Jason Mollin with Scotiabank. Please go ahead.

Jason Mollin: Hi. Thank you. I have two questions, somewhat follow up to what's been discussed. First, on the loan growth outlook for 2020 for the system of around 7 percent and your portfolio growing low double digits.

Can you talk about what you expect for the system by segment in terms of retail versus commercial? Do you think that the same trends that you saw in 2019 will continue? Or could there be more of a normalization there?

And my second question is, again, understanding better the fine-tuning of the IFRS 9 models. And you showed the detail that you referred to, again, with the question on Page 13. But what's the underlying explanation of what changed in the model? Is it a higher weight for collateral? Is it adjusting for previous payment experience? Is it something related to macroeconomic fact? Like what's driving the -- what really explains when you see this commercial stock of provisions to loans go to 1.3 percent from 1.7 percent? What really drove that? And I guess, at this point, should we expect any additional fine-tuning of the risk and expected loss? Thank you.

Michela Casassa: Good morning, Jason, and thank you for your questions. Let me complement a little bit the answer I gave before in terms of loan growth for the banking system. Basically, what we are expecting is retail loans, okay, for the system as a whole to continue to grow maybe at a low double-digit level, okay? But we are foreseeing a little bit of a recovery in commercial loans, okay? Remember that commercial loans at the system grew very little in 2019.

So, one of the things that is, if you want, increasing the overall loan growth for the system from the 5.7 percent of 2019 to the 7 percent guidance we are giving is a slight recovery of commercial loans.

And as usually happens, this is, if you want, the riskier part of that guidance. Because it happens from time to time, for example, with corporate loans that, because of capital markets or some other reasons, they can grow faster or slower. So, this would be my additional comment on that. And related, the update on the risk models.

I mean, IFRS 9 models have inside a number of variables, okay? You commented some of them as for example, collaterals, as for example, the real payment capability of clients or the forward-looking macro scenarios. So basically, it's a mix of everything you've mentioned, okay? One of the things that is making that number go down, which is, if you want, the biggest, the one that drives us to say that the risk profile of the portfolio has improved, is that the probability of default and the loss given default of the different portfolios is lower in this update that we've done versus to what we saw in previous years, okay?

So, this is impacting, again, I mean, probability of default, which is coming from the actual past data of real defaults and the loss given default, which is also coming from updating the past data of the losses we've had.

The forward-looking part, which is related to the macro variables, is also helping a little bit. But I wouldn't say it's the biggest part, okay? And why? Because there are some variables, which are expected to recover during 2020, as they can be public spending, the purchasing power of people, etc.

So, basically, it's really a mix of the different things. And then you asked me whether or not we could expect more of this coming forward. I mean, the methodology of IFRS 9 ask you to continuously update the variables, okay? Then, of course, every bank has a different way of implementing this. I don't know, the recommendation is that this should be updated.

These variables should be updated at least once a year but best practice should be every quarter, okay? So basically, what we could see is that every time we update the historical data, OK, let's imagine this on a quarterly basis, you could see an improvement or a deterioration of the ratio, depending of the new data that is entering the series of data. I don't know if I'm making myself clear.

Jason Mollin: Yes, I understand.

Michela Casassa: So basically, this is like a life model. So, the expected loss is going to be updated on a quarterly, I don't know, every six months or a yearly basis, forever. And the trends are going to be impacted by the actual past portfolio and by these forward-looking variables.

Jason Mollin: Understood. That's helpful. Thank you.

Michela Casassa: Thank you.

Operator: Thank you. [Operator instructions] We'll take our next question from Sebastian Gallego with Credicorp. Please go ahead.

Sebastian Gallego: Good morning everyone. Thanks for the presentation. I have also a couple of questions. The first one, just more follow-up on the IFRS changes and so on.

I was looking to the prior guidance on cost of risk, which you mentioned, Michela, and that was 2.5 percent to 3 percent. The new range of guidance is 2.4 percent to 2.7 percent. So, at the end of the day, it seems that the improvement is rather low when you look at the actual figures. My question is, could we expect a further improvement on cost of risk in the medium term? Or this seems also to be just a regular layer on a medium-term basis?

Second question is regarding Interseguro. I just want to get more color on the outlook for the annuities business and overall net premiums. We have seen two consecutive quarters with contractions in annuities. Just to get a sense on how to achieve also a 15 percent ROE on the insurance business. When looking at the fourth quarter's results, this is partly explained by translation results.

So, it's a mix of effects. But at the end of the day, translation result makes up for the figure. Just wondering the outlook on the insurance business. And lastly, maybe coming back to the bank. We saw a significant growth on institutional deposits. I just want to get a sense if this may have a negative effect going forward toward your NIM guidance. Thank you.

Michela Casassa: Good morning, Sebastian. Thank you for your questions. Let me start with IFRS changes. The adjusted cost of risk for the year has been reported in 2.6 percent.

This excludes, if you want, the full effect of the update of the model, okay? But basically, what this is doing is that, if you want, showing a number, an adjusted number, which is not considering a portion of this improvement that has taken place over the year. It's just that, for us, it's almost impossible to split that effect.

So, going forward, yes, the reason why we are giving a guidance of 2.4 percent, 2.7 percent is that we expect cost of risk, if you compare it to what we are seeing in this fourth quarter, which is 2.8 percent, to be somewhat better than that, okay? So, this is what has given us the comfort to go for the 2.4 percent, 2.7 percent.

And let me answer then also on institutional deposits, and I will then pass it on to Juan Pablo to comment on the translation results of Interseguro.

The institutional deposits, the increase that you have seen for year-end, I mean, this is something that if you look at quarter from quarter is a little bit volatile, okay? From quarter to quarter, we can have some big institutional deposits that stay in the bank, so this drives volumes up. But normally, these are very short term. So, I mean, actually, what has happened is that during January and a part of February, some of those institutional deposits have already left, so this shouldn't impact the cost of funds of the bank itself. So now let me pass it on to Juan Pablo.

Juan Pablo Segura: Sebastian, thanks for the questions. So, I noted three questions here: one is the annuity growth, the market growth; the other one was the return on equity, how we are going to get to the 15 percent in the guidance; and the other one was the translation rate in the fourth quarter.

So, let me start with the annuity growth. Definitely, the market has softened in the fourth quarter. On a yearly basis, the market of annuities, and this includes both the regulated and the private annuities, grew at the high single digits, around 8 percent to 9 percent, which is basically what we expect to happen in 2020. But fourth quarter was only on a lower high -- or low single digits. Fourth quarter only grew 2 percent total market, and that impacted, of course, our collections or our emission of private annuities and regulated annuities. The contraction of the market is basically because of the interest rates, interest rates in general going down.

It becomes much more competitive, of course, within the system. And we prioritize profitability rather than just growing for growth. That's one thing. And of course, there are more options out there in the market for better interest rates as they go down in the market versus going to a private annuity.

We have seen that change in December already. You're looking at the fourth quarter, but December and January have spiked up versus what we saw in October and November. So, this is a market that is volatile, and it's very dependent on what happens with the interest rates. We continue to compromise to be the market leaders in annuity, but we don't expect either in 2020 to have high growth in annuities.

And to your question on how we're going to get to the 15 percent return on equity, we are investing and we're dedicating much more of our resources to grow in the individual life insurance and our retail insurance. Both are growing double digits in the last quarters, the full year. These two segments have much higher return on equity than the overall Interseguro, if you will, profitability. And as the mix of the business changes toward life insurance and retail, we should expect the return on equity to go higher and be accretive to the overall group.

Yes, translation rate definitely was positive in Q4. And this is based out of our assets, mainly real estate that are dollar-based. That's part of a phasing, but we also had a lot of gains in the valuation of real estate that are legitimate. They're ongoing, and they should continue to drive the return on invested portfolio metric higher in the future.

So, it's a little bit the outlook of what we're expecting in the insurance segment. Did that help, Sebastian?

Sebastian Gallego: Yeah, absolutely. Thank you so much for the answers.

Operator: And there are no further questions at this time. So, I'll turn it back to Ms. Casassa for any further remarks.

Michela Casassa: Thank you, everybody, for joining the call. We will listen to each other during our second-quarter results 2020.

Thank you, everybody. Bye-bye.