Operator: Good morning and welcome to Intercorp Financial Services Second Quarter 2020 Conference Call. [Operator Instructions] It is now my pleasure to turn the call over to Rafael Borja of i-advize Corporate Communications. Sir, please begin.

Rafael Borja: Thank you, Nikki, and good morning, everyone. On today's call, Intercorp Financial Services will discuss its second quarter 2020 earnings.

We are very pleased to have with us Mr. Luis Felipe Castellanos, Chief Executive Officer of Intercorp Financial Services; Mrs. Michela Casassa, Chief Financial Officer of Intercorp Financial Services; Mr. Gonzalo Basadre, Chief Executive Officer of Interseguro; and Mr. Bruno Ferreccio, Chief Executive Officer of Inteligo. They will be discussing the results that were distributed by the company yesterday.

There is also a webcast presentation to accompany discussion during this call. If you didn't receive a copy of the presentation or the earnings report, 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) 406-3695.

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. This will not account for future economic circumstances, industry conditions, the company's future 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, sir.

Luis Felipe C.: Thank you. Good morning, everyone. Welcome to IFS' second quarter earnings call. As you are well aware, we are living under extraordinary circumstances given the COVID-19 pandemic. We hope you and your families remain healthy and safe during this testing time. Peru is one of the countries that has been hit hardest by the pandemic; as such, the economy and financial results for the system have been profoundly impacted. Our main focus continues to be the health of our employees and customers while deploying all necessary resources available to ensure we continue to help Peruvians go through this difficult situation.

As shown in the agenda, this time, we have divided our presentation in four main topics: key messages, financial highlights, second quarter results and main takeaways. I will start with five key messages, which reflect the core of our business execution during these days and that we will cover in detail in the following slides.

In Slide #3, we can see the messages. One, the strong liquidity and capital position of IFS; two, the recovery path underway in the economy and in our operating activity; three, the positive digital trends that continued to support IFS' strategy; four, our precautionary approach to provisions impacting this quarter's results; and five, our strong focus on operating efficiency to partially offset the negative impact of the pandemic in our operations.

Let's move to Slide #4. We can see a snapshot of our strong liquidity position. Our loan-to-deposit ratio stands at 97 percent, below historical levels for IFS and below the system average of 102 percent. The breakdown by currency also reflects a favorable picture with the ratio in soles at historical lows at 109 percent versus the system's 118 percent. Our total deposits evolution has been very favorable during this quarter, with growth of 18 percent, allowing us to gain 70 basis points of market share overall and 10 basis points in retail deposits market share.

Our liquid financial assets at Interbank stand north of PEN 21.4 billion, out of which close to PEN 14 billion are cash and equivalents. At the holdco level, IFS's stand-alone, we have more than PEN 900 million in liquid assets, out of which more than PEN 400 million are cash and equivalents, enough to cover IFS stand-alone operating and financial commitments for at least the next 4 years.

Moving to Slide #5, we can see that we have a solid capital position in all of our 3 operating companies. At Interbank, pro forma for the issuance of a Tier 2 subordinated bond placed on July 3, our total capital ratio stands at 16.7 percent, above the industry average of 14.8 percent and above the regulatory limit of 10.7 percent. Our Core Equity Tier 1 stands at 11.1 percent, 50 basis points above the ratio we had 1 year ago. At Interseguro, our solvency ratio stands at 145 percent, well above the regulatory limit. And Inteligo Bank, with a total capital ratio of 21 percent, also shows a very comfortable and sound capital position.

The second key message is the recovering activity. On Slide 6, we can see that economic activity in Peru is recovering from low levels resulting from the strict lockdown that has been in place. During the second quarter, we have witnessed one of the strongest negative GDP impacts in the region and probably in the world, declining 40 percent in April, 33 percent in May and an estimate of 20 percent in June. However, with the reopening of the economy, the recovery is evident, as highlighted by the June results of different indicators, including the mining and fishing GDP as well as electricity and cement consumption.

Moving to Slide 7. The economic recovery positively translates into our operating activity, which should continue during the rest of the year. We are showing data for July, and we can see that at Interbank, when compared to pre-COVID levels, debit and credit cards turnover has recovered to almost 90 percent, new disbursements of payroll deduction loans to public sector employees to almost 70 percent, new disbursements of mortgages to 60 percent and total fee income to 80 percent.

The same is true for Interseguro and Inteligo, which have seen a recovery in gross premiums to more than 90 percent of pre-COVID levels and have higher AUMs in July than in February, respectively. This improved activity should help our top line to recover during the following quarters.

The third key message, positive digital trends. Moving to Slide 8. We can see that our digital KPIs continue to show positive trends, supporting our vision and IFS's strategy. The lockdown has accelerated consumption patterns that we thought were going to take longer in Peru. So, our investments and capabilities built during the last years has allowed us to positively benefit our customers and our platforms from this change in consumer behavior.

All of our KPIs show remarkable evolution. Digital users stand at 74 percent, boosted by our web and app solutions; PLIN, the P2P feature for transfers within different banks, has already reached more than 1.4 million users in less than six months, 40 percent of which use Interbank as their key account. TUNKI, our own 100 percent digital payment solution has reached more than 400,000 users since relaunching in March.

Regarding 100 percent digital customers, which are customers that do not use branches or contact center and who use our digital channels, plus ATMs and corresponding agents only for cash-in and cash-out, they have reached 52 percent of our total customer base, up 10 points since March. Digital sales have also seen a rapid increase. At Interbank, retail digital sales reached 71 percent and Interseguro SOAT sales reached 91 percent, both increasing sharply the number of products sold versus the first quarter of this year and versus the second quarter of last year.

We continue to see a big pickup in the number of new digital accounts being opened, both for individuals and for small businesses. As of the end of June, 79 percent of new retail saving accounts were opened digitally and 81 percent of new business accounts, compared to 29 percent and 44 percent one year ago. New digital acquisition of retail customers reached 65 percent as of June compared to only 14 percent one year ago. This peak in new accounts is mainly due to two factors. On one side, the extension of the lockdown is pushing an acceleration to digital. And on the other side, the need to have an account to be able to receive the government's aid packages faster, both for individuals and small businesses. The deposits from the AFPs for early withdrawal of a portion of an individual fund is also a positive factor.

Moving to Slide 9. We see that we have reached 3.7 million retail customers and over 1 million 100 percent digital customers, with improving NPS at Interbank. Our retail customer base has increased more than 15 percent year-over-year and almost 4 percent during the quarter. 100 percent digital customers have increased more than 80 percent in one year and more than 25 percent in the quarter. All of this with higher levels of interaction and engagement, resulting in improved satisfaction as evidenced by our 39 percent and 49 percent NPS indicators for total customers and 100 percent digital customers, respectively.

The fourth key message refers to our precautionary approach in the expected losses model, leading to high levels of provisions, which have impacted this quarter results.

Moving to Slide 10. We're showing the impact of COVID on the bank's portfolio in terms of rescheduling loans and of most impacted segments. On the left-hand side, you can see our assessment of the most exposed to least exposed segments within our PEN 39 billion loan book. As the most exposed, we have 2.4 percent in small businesses followed by the 8.3 percent in retail loans to the self-employed workforce.

Next, with lower potential impact, we have the 29 percent in retail loans to private sector employees. Finally, which we believe to have the lower exposure, overall is the 60 percent of our portfolio to large and mid-corporate loans as well as retail loans to public sector employees.

On the right-hand side, you can see the evolution from April to June of the percentage of rescheduled loans within our total loan book. It has remained relatively stable at around 30 percent, in line with the system average. 43 percent of retail loans and 20 percent of commercial loans have been rescheduled. Within retail, the higher percentages refer to credit cards with 60 percent and personal loans with 50 percent, while mortgages are at close to 40 percent. Payroll deductible loans are at a marginal level.

Within Commercial Banking, 60 percent of the small businesses have been rescheduled, or 85 percent when excluding new Reactiva loans, with 28 percent of mid corporates and 10 percent of large corporates being rescheduled. As you can see from the numbers, most of the rescheduling of loans were done in April, at the beginning of the lockdown. What we have experienced in the following months, especially within the retail portfolio, is that the same clients have requested to reschedule additional installments and to a lower extent, have requested the total debt rescheduling.

The rescheduling of loans has had different terms, including grace periods, breaking up installments with 0 interest rates in 12, 24 or 48 months, new overall payment schedules at the original interest rates or with the reduction of rates in some cases. It is worth to note that during July, we have seen an improvement in the behavior of payments of these loans when compared to the previous months. However, it is still too early to draw any conclusions as only a small portion of rescheduled loans have required a payment so far. Most of these payments will start to mature in August and afterwards. At that time, we will be able to most effectively understand the payment behavior of clients to come up with a more detailed conclusion on the overall impact in the portfolio.

As a result, and moving to Slide 11, we have taken a cautious approach in the adjustments made to the expected loss model to determine provisioning levels. The adjustments we have done include, first; we have updated our forward-looking model with the latest macro variable. Second, within the credit card and personal loans portfolio to private sector employees, we have migrated from Stages 1 and 2 to Stages 2 and 3, the customers with multiple installments or total debt rescheduling. And three, within our commercial loan book, including SMEs, we have run a case-by-case analysis.

These adjustments to the expected loss model resulted in a cost of risk for the bank of 13.4 percent for the quarter and 8.5 percent in the first half, as we have accelerated migrations between the stages upfront and made Stage 2 and Stage 3 loans over total exposure to move up around 10 percentage points from 13 percent to 23 percent. The biggest impact of these changes related to the retail loan portfolio, and this is the main reason why the cost of risk for retail loans reached 23 percent in the quarter and 14.5 percent in the semester.

NPL coverage for the bank as of June is at more than 180 percent and for retail loans is at more than 200 percent. It is important to have in mind that these coverage ratios will change as clients start to migrate between stages and their facilities start to mature. We believe this will be the quarter with the highest cost of risk, as we have tried to anticipate to the expected losses to come, aiming to digest the majority of the COVID impact this year 2020.

However, we also believe that we will still see higher provisioning levels when compared to pre-COVID levels during the next couple of quarters. As mentioned, we will be able to refine our calculations during the following months based on having a better understanding of the new payment behavior of clients.

Finally, moving to Slide 12. The last key message refers to operating efficiency. As we've mentioned, there is uncertainty around customer behavior, provisions and income for IFS in the months to come. What we have more control of is the level of expenses and disciplined and proactive management of costs. We have been very focused on this since COVID started, which has allowed us to achieve a double-digit reduction in costs in the second quarter when compared to the previous year and to improve our efficiency ratio at IFS and in each operating subsidiary.

As a result, the efficiency ratio for IFS is at 30 percent in the quarter, with Interbank at 35 percent. Measures taken include the continuous optimization of our branch network, having closed 22 additional branches during 2020, reaching a total reduction in the number of branches of 20 percent from the peak in 2016 and more than 8 percent this year. Also, we have some variable costs related to credit card activity and incentives that have decreased substantially during the quarter, in line with the decrease in activity. We are actively managing every line of expense through an important cost containment program in all operating companies.

Now let me pass it on to Michela, so she can go a bit deeper in the results of the quarter. Thank you.

Michela Casassa: Thank you, Luis Felipe. Good morning, everybody. Now let me move to the second section of the presentation related to the financial highlights from Page 14 to 18. Main highlights are, at Interbank, the second quarter earnings are affected by higher provisions from COVID-19 and low activity during the lockdown. Loans are outgrowing the system, with market share up 12.6 percent, boosted by our participation in the Reactiva Peru program; strong growth in deposits drove market share up to 13.2 percent and cost of funds down 50 basis points in the quarter; 8.5 percent cost of risk in the semester based on the adjustments to the expected loss model and double-digit reduction in expenses due to the cost containment measures mentioned by Luis Felipe.

At Interseguro, solid quarter, thanks to a recovery in the investment portfolio; top line impact from the COVID-19 pandemic, offset by lower claims and benefits and tight control of expenses; results from investments increased 50 percent quarter-on-quarter and 6.5 percent year-over-year with return on investment portfolio reaching 6.3

percent, continued as the market leader in annuities with a 27 percent share year-to-date.

At Inteligo, solid quarter with recovery from investments and fees; strong revenues in the second quarter, positively affected by mark-to-market on the investment portfolio; fee generation remained solid despite economic turmoil in the region; assets under management and loans grew 7.2 percent and 3.2 percent quarterly, respectively; significant bottom line recovery at Inteligo with return on adjusted equity of 17.2 percent after a challenging first quarter.

At IFS, the second quarter earnings were affected by the higher provisions at Interbank, partially offset by positive results from investments at Interseguro and Inteligo; strong liquidity and capital position across all subsidiaries, adjusted efficiency ratio at 30 percent, an improvement of 650 basis points on a quarterly basis and 510 basis points year-over-year. As mentioned before, the activity is recovering from COVID-19 lows and the digital trends continue to support IFS strategy.

Now let's have a closer look at some additional indicators and trends by segment on Slide 20 to 28. On Slide 20, we are showing that COVID-19 has impacted most of the key banking indicators. NIM decreased 60 basis points in the quarter, down to 5 percent, excluding the one-off impact of net interest income, which accounts for 100 basis points on NIM in the quarter. The decrease in NIM is related on one side to the portfolio mix, with retail loans decreasing 3 percent and credit card loans 9 percent in the quarter, and on the other side, to the Reactiva loans at low yields. Impacts from Reactiva loans is around 10 basis points in the quarter.

Total other income decreased 28 percent in the quarter, mainly impacted by a reduction in fee income of 41 percent due to the strong decrease in transactional volumes in the quarter, especially in credit card-related fees, but also to lower activities in other retail and commercial products.

On Slide 21, our year-over-year loan growth has accelerated this quarter, mainly thanks to the Reactiva loans disbursements, reaching 10 percent in the quarter and 19 percent in the year. Commercial banking grew 26 percent in the quarter and 37 percent in the year, while retail banking decreased 3 percent in the quarter, driven by the 9 percent decrease in credit card volumes. The strong growth in commercial banking, together with a lower reduction in the retail portfolio versus the system has led to an increase in our total loan market share of 30 basis points in the quarter.

On Slide 22, we have helped our clients to finance their working capital needs throughout the lockdown with the Reactiva loans. As of the end of June, we have disbursed PEN 3.8 billion in loans, increasing our commercial loan book 28 percent. Most of the loans have been granted to mid-corporates and small businesses, increasing our portfolios 50 percent and 33 percent as of June, respectively.

As of August 11, 28 repo auctions have already taken place in the country for a total amount of PEN 52 billion or 87 percent of the total amount to be disbursed. Interbank has been able to obtain PEN 6.5 billion or 13 percent of the funds, which is slightly above its market share in commercial banking of 9.5 percent. The funds distribution has been PEN 2.6 billion in the 90 percent guarantee bucket, PEN 2.1 billion in the 80 percent guarantee bucket and the rest between the 95 percent and 98 percent guarantee bucket. We have already disbursed around PEN 5.6 billion as of today.

On Slide 23, total deposits speed up their growth during this quarter, growing 18 percent in the quarter and 25 percent year-over-year, allowing us to gain 70 basis points market share in the quarter, reaching a record 13.2 percent. Retail deposits grew 12 percent in the quarter and more than 25 percent year-over-year, gaining 10 basis points market shares in the quarter and reaching a record 13.8 percent market share as of June.

Due to banks, which include the funding from the Central Bank for the Reactiva Peru program has increased more than 50 percent during the quarter, in line with the disbursement to our commercial clients. One very positive development is the improvement in the cost of funds of 50 basis points in the quarter and 80 basis points year-over-year, down to 2.2 percent, coming from a combination of a decrease in rates and a better funding mix, considering the Central Bank's funds and the maturity of the Tier 1 bond in April.

Moving on to the insurance segment on Slide 25. Monthly premiums show a recovering trend after a 35 percent decrease on a quarterly basis. During the second quarter, all the business lines contracted, with private annuities contracting the most followed by regulated annuities and retail insurance and to a lower extent by individual life. Looking at July numbers, we have seen a strong recovery in all business lines with individualized and private annuities already above pre-COVID levels. Interseguro remains market leader in annuities with a 25.5 percent market share in the quarter.

On Slide 26, Interseguro's investment portfolio reached 12.7 billion, a 7.5 percent increase on a quarterly basis and 4.5 percent on a yearly basis. Results from investment recovered from the first quarter, reaching 6.3

percent and also 30 basis points above the second quarter 2019 return on investment.

Moving on to our wealth management segment on Slide 27, strong revenues in the second quarter positively affected by mark-to-market in other income, which reverted from a negative PEN 86 million in the first quarter to a positive PEN 10 million in the second quarter. This improvement in other income has led to an increase in total revenues at Inteligo from a negative PEN 17 million in the first quarter to a positive PEN 71 million in the second quarter.

On Slide 28, Inteligo asset under management reached PEN 19.3 billion in the second quarter, a 7.2 percent increase on a quarterly basis. Loans increased as well during the quarter 3.2 percent. Thanks to the recovery in the top line and the decrease of other expenses of 24 percent on a quarterly basis and 7 percent on a yearly basis, Inteligo's net profit of PEN 33 million was PEN 88 million above the previous quarter results.

Finally, on Slides 30 and 31, let's have a look at the potential trends going forward and some key takeaways of this earnings call. On Slide 30, guidance remains suspended at this time, given the high level of uncertainty of the months to come. Instead, we wanted to share with you some trends that, given the information that we currently have and the assumptions that we can make today, could materialize through the rest of the year.

First, we believe we will be able to maintain solid levels of capital given the increased capitalization and lower growth, as well as adequate levels of liquidity. Second, the overall activity should continue to recover as seen in the past two months, while Reactiva loans to continue boosting commercial loans growth.

Third, NIM will continue to be impacted due to lower retail loan growth, Reactiva loans with low yields and to the loans rescheduling impacts, despite the lower cost of funds in the months to come. We expect a lower cost of risk in the rest of the year after the peak registered in the second quarter. We also expect a recovery in fees given the trends already seen as of July. And we expect lower costs, thanks to the cost containment measures being deployed.

On Slide 31, I want to close the presentation with a brief summary of the 5 key messages Luis Felipe introduced at the very beginning of the presentation. Number one, we have a strong liquidity and capital position, which we have substantially improved when compared to pre-COVID levels. Number two, activity is recovering from COVID lows, both in the country and at IFS, which should positively impact future results.

Three, the digital trends continue to support IFS' strategy, which translates in growth of clients and business outperforming the system. Four, the high provisioning level is impacting this quarter's results as we are taking a precautionary approach on the adjustment to the expected loss model. And five, double-digit decrease of costs in the quarter at IFS due to cost containment measures already implemented in each of the three operating companies is partially offsetting the top line impacts.

Thank you very much. Now we welcome any questions you may have.

Operator: [Operator Instructions] And our first question comes from the line of Ernesto Gabilondo with Bank of America.

Ernesto Gabilondo: My first question is on provision charges. As you mentioned, you built a lot of provisions this quarter, and then you're expecting a downward trend in the next quarters. However, we would like to know if the future level of provisions per quarter will normalize to the levels that we saw during the first quarter, or do you think they could continue to be a little bit higher?

Then my second question is on Reactiva. You mentioned that you have participated with PEN 3.8 billion. But how much do you expect Reactiva loans to represent of your total loan portfolio considering the first and the second round? Will it be another PEN 3.8 billion? And I would appreciate it if you can break down what are your expectations for the loan growth with Reactiva and without Reactiva. And the same for NIMs, what do you think would be the net NIM pressure, only considering the impact from Reactiva?

And then my last question, we saw the important reduction in operating expenses to mitigate some of the impacts related to COVID-19. So, would it be reasonable to expect OpEx to decline this year?

Luis Felipe C.: Hi Ernesto, it's Luis Felipe. Let me deal with a couple of your questions. First, regarding cost of risk, yes, we do believe this is at the highest level. As mentioned, we're still working through the numbers and the models. We do expect that the next quarters will be lower. We don't fully expect to get to the levels pre-COVID. We expect the cost of risk to be higher than pre-COVID levels. We still foresee that we would have to digest some of the remaining impact.

Then next quarter, again, lower than this quarter, higher than pre-COVID levels, with the aim to digest all the impact, or most of the COVID impact during this year, having then the first quarters of next year more close to COVID level--pre-COVID level with the information we have now. That's based on the current situation, based on the economic recovery that we foresee for 2021. And obviously, that will depend on the overall sanitary conditions of the--of the country.

Let me pass it on to Michela for your next questions.

Michela Casassa: Related to the participation of Reactiva loans in the total portfolio, as we've shown in Slide 22, we, at the total commercial--total commercial loans of Reactiva represents around 22 percent, which would mean it is around 10 percent to 12 percent of the total overall retail book. This will slightly increase in the months to come with the second portion, and it could reach around 25 percent of the commercial loan book, so something between 12 percent to 13 percent of the overall loan book.

Now moving on to the loan growth for the full year, with the same estimates, I'm giving you about the Reactiva for the second phase. We would reach a double-digit loan growth in the year, including Reactiva. But when excluding Reactiva, the actual loan growth, we are expecting is something like flat, flat or even slightly below the previous year.

And talking about NIM, as you have seen already in the current numbers, NIM has been impacted by a number of reasons. We are showing a 5 percent NIM, which actually is a 4 percent NIM adjusted. We are expecting more impact from NIM in the second half of the year as we have the full extent of the Reactiva loans in the portfolio. So, basically, we have 10 basis points impact on NIM from Reactiva today, and we expect that impact to reach 20 basis points as of year-end. So, we will still see NIM declining a bit compared to what we have seen in this quarter.

I guess there was one more question, which I didn't get. Sorry. Unless Luis Felipe did.

Luis Felipe C.: Yes, it's about the overall cost base. We do expect that given that the measures that are already in place and that we have taken since the beginning of April, the total cost base could be around 5 percent lower in 2020 than in the previous year. That's what we're shooting for.

Operator: And your next question comes from the line of Jason Mollin with Scotiabank.

Jason Mollin: I have two questions. My first is on the cost of risk and provisioning. You cited the cost of risk of 13 percent for Interbank in the second quarter, also with the retail banking at 23.6 percent. Based--I guess this is based, as you mentioned, on a precautionary approach in an expected loss model. So, can you talk to the assumptions that you're making in this model in terms of the length of the economic--the length and depth of the economic downturn, the lockdown and expected recovery. Is that an important part of this that the economy recovers next year?

And my second question is that you showed some pretty positive data, monthly data for July 2020, indicating recovery, showing in the presentation, the credit card--or the credit and debit cards turnover, the originations of payroll and mortgage loans, fee income recovering, premiums recovering and assets over--assets under management at Inteligo back to where they were in February.

If you can talk perhaps of what you've seen in August and what--so far in August, and what are the pros and cons here or the positives that could make this continue or the concerns you have. It sounds like we're hearing they're putting some more restrictions on individuals in Peru based on COVID.

Luis Felipe C.: Okay, Jason, Luis Felipe here. Thanks for your question. I'm going to go first with the second question. August is following the same trend that we are seeing--that we saw in July. So, in terms of activity, August is following the same trend. So, again, we expect this to continue recovering in line with the overall expectation of the GDP impact for the country has been like that, the worst has already gone through. That is, as you referred to, the current assumption of the existing conditions, the sanitary situation. And as you know, Peru is not--less completely in control of the situation. We actually saw kind of some control, but once the economy reopened, it was naturally unexpected to have the cases go up. We are undergoing that process now, but this is something that we did not expect.

There was lots of concern. But given this, the country will go back towards strict measures. Yesterday, the new measures were announced. And although we don't like them because they have added lockdowns on Sundays, everything else remains the same. And some specific provinces that are seeing a strong impact are also being postponed on a stricter quarantine, but that are more kind of rural places. So, no like big changes in the country overall, except for the Sunday lockdown, which could have a marginal impact in terms of the activity itself.

So, we do expect August to be better than July in terms of activity, and hopefully, the months to come, we will follow that pattern. And the only different things get to the payment behavior of customers. July is a very liquid month because Peruvians received--like Peruvians that are dependents receive an extra salary. So, that's why we saw July very positive in terms of payment patterns, but we don't want to draw specific conclusions. August will be a better month for us in order to assess because it's--that doesn't have the uptick in liquidity that Peruvians get but also because most of the rescheduled loans will have end their grace periods. So, we will be able to get more data in terms of absolute level of payment.

So, we do expect a positive August compared to July in terms of activity. And it will be an important month for us in order to properly assess if the level of provisions that we have foreseen is on the right track, which, again, we strongly believe we are on a very precautionary mode. And we've done lots of adjustments in order to be very acid and conservative. And I'm going to pass it on to Michela, so she can explain a little bit more the specifics that we've done in order to move forward as much as possible to anticipate as much as possible the potential impact in terms of provisions in this situation.

Michela Casassa: Okay. Thank you, Luis Felipe. Let me go through the specific adjustments we've made to the expected loss model again. And I will give you also some more details so that you can understand a little bit more why we believe we've been on the conservative side. So, as Luis Felipe mentioned, we've done a number of adjustments. Now first, versus what we presented in the first quarter, we updated the macroeconomic variables. So, basically, in normal situations, the macroeconomic variables should reflect the changes of the environment, if you want, the macroeconomic conditions into provisions.

But as we all believe this is not enough we are, on top of that, doing some additional adjustments both on the retail portfolio and on the commercial portfolio. The greater adjustments are being done in the credit card and consumer lending portfolio. So, basically, as most of the clients are kind of softened in terms of base, and a big portion of the portfolio has been rescheduled, we cannot figure out today the behavior of payments of these clients. So, what we are doing is taking the behavior of rescheduling.

So, basically, the different types of rescheduling, whether a client has been rescheduled only one installment or more than one installment or whether he or she has requested a structural rescheduling of his debt, then we are moving groups of clients between stages. So, we are kind of accelerating their deterioration. So, basically, we're taking clients from stage 1 to stage 2, and clients from Stage 2 to Stage 3. This is the main reason why the nonperforming exposure and the Stage 2 and Stage 3 over total exposure ratio, as you have seen in our slides, have increased in the quarter, reaching 13.4 percent, Stage 2 plus Stage 3. But if we consider the adjustments that we are doing to the expected model, then that number actually goes up to 23 percent. So it is a big adjustment that we are doing.

And if we were to see that specific movement in stages 2 and 3 over the exposure of credit cards, which is the portfolio we are stressing the most, those numbers will move from around 22 percent to above 40 percent. So, those are really big numbers, which, again, as Luis Felipe mentioned, once we start seeing the behavior in the payment capabilities of clients, we will be able to adjust.

And as far as the commercial loan book is concerned, what we have done there is to run a one-by-one case analysis, especially for small businesses, which luckily, if you want in this situation, it's a small portfolio, but also in the midsized and large corporates. But numbers there are much more limited in terms of the cost of risk, first because of the impact and second, also because of the help of the Reactiva loans.

Luis Felipe C.: Yes. And just to complement, Jason, I think an important thing is we think the SME and micro portfolio, microfinance portfolio, will be hit the hardest, and as Michela mentioned, given that we're not that big in that book, we've been able to review something--very tough to do in this type of portfolio but we've taken a one-to-one approach. So, we've contacted most of our customers, not only to do statistics and analysis, but also to have more concrete qualitative information of the actual situation of those.

And that's what we're seeing. We're seeing those customers like 80 percent have had some type of refinancing, those are the ones that have been hit the hardest. Those probably are the ones that are going to have a higher cost of risk, but they have very limited impact in our portfolio as they are only like PEN 900 million over our more than PEN 30 billion--or close to PEN 30 billion exposure. And then comes unsecured financing for retail customers, and that's what we are stressing the most.

Operator: And we will move next with Adriana De Lozada with Scotiabank.

Adriana De Lozada: I have just a quick question on expenses. As you mentioned, you moved to double-digit cut in expenses this quarter. And I just wanted to have a sense if we are going to see a similar magnitude in the following quarters. I know this is part of an overall push by the bank but we wanted to know what magnitude you're expecting.

Luis Felipe C.: Thank you. Yes, we've put a very strict cost containment program in place since, again, the beginning of the pandemic. But this quarter, specifically, we have done like double running if you want, because, one, is the cost controlling measures, but also the significant slowdown in activity. So, some of the variable costs related to, for instance, credit cards, including marketing costs or payment to certain strategic partners or even incentives to our workforce naturally have been down because of this lack of activity.

So, if activity recovers, that part of variable costs will come up, hopefully, with the corresponding increase in income. And then the overall structural measures that we have been taking and continue to take will remain in place. So, as mentioned, we are shooting that the overall cost for--that we're shooting for, being able to the overall cost base of 2020, to be at least or close to 5 percent lower than the previous year.

Operator: And your next question comes from the line of Sebastián Gallego with Credicorp Capital.

Sebastián Gallego: I have a couple of questions. The first one, if you could elaborate a bit more on the one-off impact that you recorded this quarter given the modification of contractual cash flows due to the loan rescheduling. I would like to know how was that conducted and whether or not--even though it says it's a one-off, if we could potentially see additional impacts going forward on the NII line.

Second question is regarding liquidity. I was looking at the presentation, and I didn't find it. If you could provide the LCR ratio that the bank is running right now or as of the end of the second quarter, that would be very helpful considering the current environment.

And finally, I noticed also that your models, your economic models are suggesting a rebound of the economic activity in 2021 of 11.5 percent. How does--are you assuming that a vaccine will come in early 2021? Or what are you assuming on that 11.5 percent GDP recovery, which looks high--a little bit high, to me at least?

Luis Felipe C.: Okay. It's Luis Felipe. On your first question, the adjustment is based on international accounting standards. What you have to do is you have to do an NPV value of the new cash flow expected of the rescheduled loans. The discount should be done at the original interest rate of the loan being rescheduled. And the difference in the NPV versus the original amount of the loan is the deterioration in value, or if you want the negative impact that we do at one time. It's a noncash event. And then going forward, once you start collecting those loans, you will see a positive impact month-by-month or quarter-by-quarter to offset this one time.

So, given the current situation, what we--if we expect anything, it's a positive impact quarter-by-quarter of the recovery of these loans that have been rescheduled. Could we do more? If the sanitary conditions continue, and we need to do like, again, massive rescheduling at zero interest rates, which I doubt, we will have to do something similar and go to the same process. But at this stage, based on what we see, highly unlikely.

I'm going to jump over the third part. Basically, what we have in terms of macro projections, is what most think tanks in Peru are saying, we work with mutual process with Apoyo, Macroconsult; we also look at what Moody's is saying, so that's the view we take. And the 11 percent is basically a rebound over the low level of this year, again, with a 40 percent and whatever in the statistic quarter, and that run into the rest of the year would make that GDP for this year will be very low. And then the next--just for the rebound effect and better control of the pandemic. Those are the numbers that we're seeing. It's not specific to any correlation to the vaccine coming in or something like that.

And for your question #2, let me pass it on to Michela, which I guess she can help you.

Michela Casassa: In terms of liquidity coverage ratio, we are at around 123 percent at the beginning of July in terms of soles and more than 260 percent for dollars. Those are the ratios.

Operator: And our next question comes from Andres Soto with Santander.

Andres Soto: Good morning to all and thank you for the presentation. I would like to go a little bit deeper on the discussion on margins. When we saw this quarter's performance, we saw a 30-basis-points contraction for the NIM on loans, including a 10-basis-points effect of Reactiva. But excluding the Reactiva effect, I would like to understand this 20 basis points obviously have also the effect of the change in the loan mix. But to what extent the lower rates in both soles and dollars are putting some pressure on your asset yield?

And also, considering the current discussions in Congress, some of them related to a potential interest rate cap for consumer loans in Peru, to what extent that is putting some pressure on the bank's ability to charge higher rates and they, as a precaution, are reducing the rates for their customers?

Michela Casassa: Andres, thank you for the questions. Let me go over the yield part. I would say that what you have seen in this second quarter, the biggest impact of the decrease in NIM is related to the portfolio mix. So, basically, if you see what has happened between retail and commercial, basically, the volumes have turned. We used to have kind of 55 percent retail, now it's closer to 45 percent. And the portfolio that has decreased the most has been the high-yield credit cards, when you've seen credit cards decreasing, I mean, close to 10 percent in the quarter.

So, that is what is putting most pressure on NIM and which, as the retail portfolio and the credit card portfolio starts to recover, should help NIM moving upwards. That is only going to happen, we believe, next year but because even with recovering volumes in retail and credit cards, we expect year-end volumes for retail, specifically for credit cards, to be below one year ago.

So, I will pass it on then to Luis Felipe for the Congress part. But I just want to point out that the biggest impact is loan mix. There is some decrease in rates that has to do with the rescheduling of loans, etcetera. But for sure, mix is what is pushing the mix down this quarter. Luis Felipe?

Luis Felipe C.: Yes. And just to close on your question about the discussions in Congress is doing any effect in our pricing, not really, that goes under separate ways. The price--our pricing is related to risk we take in terms of the segments that we are serving. And that goes in a different view compared to the specific regulation.

Now that congress discussion is starting. We don't know where that is going to end. However, just to close up, it's not affecting our current decisions right now. We are obviously following the situation very closely and taking all the necessary measures in order to ensure that whatever goes through is according to sound practices and according to the legal framework of Peru. But that's a separate discussion in terms of how it is impacting and what segments we are serving now in our business model.

Andres Soto: Perfect. And then a second question on the Reactiva 2, part of the government guarantee scheme. Are you targeting the same market share that you got in the Reactiva 1, or is it going to be a different one? And given that these funds are intended more towards the SME and micro-lending segment, which you--as you mentioned before, are not a big exposure in your portfolio, the focus of this money, when you get it, is going to be to support your current clients? Or are you going to use this money as an opportunity to deepen your penetration in these segments?

Luis Felipe C.: Yes. Thanks for your question. Yes, we are targeting to get the same level in terms of Reactiva 2 of what we got in Reactiva 1, probably a little bit below. Reactiva 1 was mostly, in our case, directed to two main efforts: to help existing customers both corporate medium sized and small companies and also to get some new customers, okay, to help some new customers in terms of credit for the bank, but had some relationship before to different products.

Reactiva 2 changes a little bit in terms of our effort. We are aiming to go lower in terms of the size of the companies. And what we're looking for is help as much as we can with liquidity to different types of companies, but also it brings an opportunity for us on what you just mentioned. We've been very conservative in serving the SMEs because it's a tough business to be in during the cycle. And we're always working on improving models and whatnot, but that has not been very successful from our perspective. So, we are small in that business.

But today, we have this opportunity to increase our client base through Reactiva, help more people go through this tough situation, but also will enable us to learn much more about this segment in order to improve our models and come up with better services for this type of segment. So, it's both. We're going to help a lot to this segment, and we will be able to learn and be closer to this type of customer. So, we do expect a positive impact in terms of our relationship with this type of customers due to Reactiva.

Operator: The next question comes from Yuri Fernandes with JP Morgan.

Yuri Fernandes: I have a follow-up on margins. I understood that we could say there's 10 bps pressure this year, so about 20 bps from Reactiva loans. But I also think that the increase of Stage 3 loans for the coming quarters, that could have an impact on your non-accrual book, right? And also, Reactiva should be a three-year loan, right, like the Reactiva 1 and 2. So, it is a long--this negative effect is something that will stay on your balance sheet for a while.

So, my question is, how do you think margins, right? Because I understood it will come down, but how much down do you think it's possible for margins to keep you under pressure?

And my second question is a follow-up on the Congress discussion. If you can enumerate maybe the top three views you are seeing there. I think there is this on interest rate cap. There was another one on automatic postponing of additional installments, and we also have the additional pension withdrawal. So, if you--I don't know like maybe comment on the things that are your concern today? And what is the status on that? That would be helpful for us.

Michela Casassa: Thanks for the question. Let me try to go a little bit deeper into the margin discussion, maybe breaking it down between businesses, okay? Starting with the commercial loan book, okay, and taking away the Reactiva discussion because, actually, in all those numbers, as I mentioned, the impact was 10 basis pointing this quarter. It will go up to around 20 basis points as of year-end. But of course, also, the yields of the commercial loan book, overall, especially because of large corporates and mid corporates is going down because of the decrease in rates. So, there is an impact there as well.

But the numbers there and the margins there were already kind of low. So, there is an impact, but it's not to such a big extent as the one we see when we look at the portfolio mix and at what is happening in retail. So, basically, besides the portfolio mix impact that I described before, which is actually not quite high because we are seeing retail decreasing its share over the total loan book of 10 basis points and credit cards, even more than that. We see some declining yields as well in the consumer loan book, especially, which has to do with some of these activities of scheduling of loans. So, it's a mix of a number of things.

I mean I wouldn't want to give you a number or guidance in terms of NIM because, really, it would depend on the speed of the recovery of the retail portfolio and a number of things. But what we are foreseeing for the second half of the year is that NIM will be lower than what we have seen in the first half of the year. And this is because you have the full extent of the Reactiva loans impact throughout the second half of the year. You also have the full effect of the decrease in rates, which impacts the commercial loan book and also the full extent of the different portfolio mix, which started to change only in March.

So, this, I would say, is the main reason of those trends. And now let me pass it on for the Congress discussions to Luis Felipe.

Luis Felipe C.: Hi, Yuri. So, yes, the Congress is obviously something that we are following very closely. And first of all, what's the backdrop here? The congressmen, obviously, they want to help Peruvians in this situation, okay. Because obviously, the impact has been very big. So, we understand that. We're sympathetic with that, and I think that we need to align our visions in order to come up with solutions that do a couple of things: first, help Peruvians go through this crisis; but second, respect the institutional framework and the model that has helped Peruvians build a very solid financial industry that is very well regulated and that has been helping our economy to grow.

So, on that framework, we are working as an association, together with experts, in trying to explain the situation to Congress. And we've made some progress because we've been seeing initiatives and many of them over the last--since the pandemic started. But so far, the terms of what is being proposed have been changing in order to address some of the concerns that the regulator and the players in the system have been having. And also making sure that there are not constitutional violations on this front.

So, we are still waiting to see what happens. We cannot predict the final result. We're doing the work as an association, and the financial players need to do in order to make sure that whatever comes through is something that, if any, that will definitely get the objective of helping without debilitating the system. The banks, we have done lots of rescheduling already, probably the highest level in Latin America. And as you've seen in our numbers, like the numbers were huge in terms of rescheduling in April and lower in June and July. So, the aim is to help whoever really needs the help.

Now in terms of the specific dynamics of Congress, there--it changes every day, as you know, the latest developments are that the economy commission is asking to take more control of all the projects relating to the financial system. And apparently, they're going to be successful, which is good news because this is the one that has like a more technical support in terms of preparing their paperwork.

However, still, it's not very clear what the outcome will be. We are taking all the measures. We're prepared to take all the necessary measures in order to make sure that whatever comes to, it's acceptable according to the regulatory framework. But that's where we are right now with some uncertainty on that front, but we're working in order for this to have the expected impact and not an unexpected impact.

Operator: And your next question comes from the line of Carlos Gomez with HSBC.

Carlos Gomez: One more question about the margin, and I realize that we are discussing this today. You are indicating that the margin will be lower in the second half of the year. We understand that. But should we understand that there's going to be further decline in NII, in net interest income, from the level that we have seen in the second quarter? Is that what we should expect that the third quarter and the fourth quarter should see NII decline from the absolute level of the second quarter?

And second, I wanted to ask you about capital and dividends for next year. Obviously, this is not a year in which you are making a lot of money. However--do you, at this point, expect to have a dividend in 2021? And do you have any considerations regarding the debt that IFS, as a holding company, has and whether it needs, or it does not need a dividend from the bank to service it?

Michela Casassa: Carlos, just to finalize the discussion on margins, yes, you're right. I mean we are expecting a slight decline in net interest income for the second half of the year because of the previously mentioned reason, yes. For capital and dividends, let me pass it on to Luis Felipe.

Luis Felipe C.: Yes, it's very early. Our focus is not like in thinking about dividends. So, I think we're very focused on executing our plans, in helping customers go through the process and whatnot. And we have strong capital, but probably it's more time to continue to building the strength of our capital, than be thinking of dividends. It's still early to tell, but the focus will be in making sure that we have the right capital levels in order to pave whatever the extent of the impact of the pandemic.

At our holding company level, where we have obligations, both from operational obligations and financial obligations, as mentioned in the presentation, we have ample cash and liquid resources that will--just with the cash on hand that we have, we will be able to comply with the financial requirements and operating requirements for the holding company for the next four years. And then on top of that, we have our liquid investments that we could also use for that. So, that's not a specific concern for us at that moment.

Carlos Gomez: That's very clear.

Michela Casassa: Carlos, let me just add one more thing, sorry, on the discussion on margins. I mean on the opposite trend, we will see, as I was mentioning, net interest income going down in the second half of the year. But we will have both fee income and other income recovering from the low levels of the first half. So, those two would kind of offset the decrease that we will see in net interest income. This is what we are expecting for the second half.

Carlos Gomez: And this recovery in fee and other income is mostly from the credit cards?

Michela Casassa: Yes, but not only credit cards. Because actually, I mean, the most impacted things have been credit cards in fee income, but also other retail and commercial banking fees have been impacted because of the low level of activity. So, we are expecting a recovery in most of the fees, as we have shown in the numbers as of July, which are already at almost 80 percent of pre-COVID levels.

Operator: And your next question comes from the line of Johanna Castro with Itaú.

Johanna Castro: I just have one question that is not really a question, this is just to double-check my understanding of some of Michela's comments, and a question on capital and guarantees. And the first thing is that listening to Michela's comment on the adjustments to the components of exposition of default, actually, there is a natural incentive for you to move the current clients to Reactiva Peru because of the exposure to default--and the exposure to default in Reactiva Peru clients is lower as the guarantees are there. And I guess you have that incentive during--in the coming months, move the clients to that type of program.

And my second question will be if you are running currently updates on the valuation of your guarantees, or if there is a waiver from the Superintendency of Finance to do those updates in the current months and postpone them?

Luis Felipe C.: Yes. It's Luis Felipe. On your first question about the Reactiva, actually, the Reactiva program is designed to help clients with the liquidity and the working capital requirements, basically, pay suppliers, to pay payroll. And actually, you cannot use that money to pay or prepay financial loans other than current installments coming in place. So, given by design, also, but the way we see what's the best way to strengthen our customers in terms of our companies, because Reactiva is designed for companies, it's not that, that incentive is there because there are limitations. And obviously, we want to build lasting companies, not just to recover part of our debt.

And then, can you please repeat your second question? I didn't get it completely.

Johanna Castro: Yes. It's just related to guarantees. And usually, you have to make revisions of the valuations of the guarantees that you receive for the regular credit in any of the portfolios you have. So, in other countries, the Superintendency of Finance has given away waivers to actually not update those valuations at the current moment in time. So, my question was, if there is such a consideration from the Superintendency or if you are running, currently, valuations of--for example, in mortgages, if you're updating the valuation of the underlying assets on mortgages, etcetera.

Luis Felipe C.: Yes, okay. Yes, on that front, the Superintendency, specifically for the banking system, has not issued any specific regulation. So, we are doing business as usual. If we need to recalibrate because it's time to do the update of value of the guarantee in a portfolio, we will just do it and it would change the value. We take that into consideration. We have not seen a big impact there. Specifically, for mortgages, our loan-to-value is at around 55 percent. So, we have ample capacity there in terms--to digest any potential reduction in the value of guarantees. But no, it's--going straight to your question. There has not been regulation enacted by the Superintendency for the banking system to do anything different with the guarantees as we have been doing pre-COVID.

Operator: And our next question comes from Jan Thomson with Autonomous.

Jan Thomson: Apologies if this question has already been asked, but my line has dropped a few times, so apologies to everyone else that's out there. But when you--Michela, when you say you expect NII to decline, is that from the reported second quarter base? Or is that after adding back the one-time charge?

Michela Casassa: Jan, no, that's after having added up the one-off charge, something--the normalized 5 percent that we have reported for the bank.

Operator: [Operator Instructions] And we have a question from the webcast that says, could you please give me a bit more detail on the 330 bp fall in retail loans yields? Is it due to temporary relief programs, renegotiated loans, grace periods, etcetera?

Michela Casassa: Just maybe to--I guess we've covered this already. Specifically, within retail loans, again, within retail loans, it would be the decline in the credit card portfolio, which is the one with the higher yields, the one that has impacted the most. Yes, there is also an impact from the relief programs, etcetera. But for sure, the biggest impact is the portfolio mix within retail again.

Operator: And it appears that we have no further questions at this time. I would like to turn the floor back over to Mrs. Casassa for any closing remarks.

Michela Casassa: Okay. Thank you, everybody, for joining this call. I hope we have been able to give you some additional information--if not all the information that you would have heard, and we'll listen to each other with the third quarter results. Thank you very much.