Intercorp Financial Services

Fourth Quarter and Full Year 2023 Earnings Call

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CORPORATE PARTICIPANTS

Luis Felipe Castellanos – *Chief Executive Officer, Intercorp*

Michela Casassa – *Chief Financial Officer, Intercorp*

Gonzalo Basadre – *Chief Executive Officer, Interseguro*

Bruno Ferreccio – *Chief Executive Officer, Inteligo*

Carlos Tori – *Executive Vice President of Payments Intercorp Financial Services*

PRESENTATION

Operator
Good morning, and welcome to the Intercorp Financial Services Fourth Quarter 2023 Conference Call.

All lines have been placed on mute to prevent any background noise.

Please be advised that today's conference is being recorded.

After the presentation, we will open the floor for questions. At that time, instructions will be given as to the procedures to follow if you would like to ask a question. Also, you can submit online questions, today, using the window on your webcast and they will be answered after the presentation during the question-and-answer session.

Simply type your question in the box and click “Submit Questions”.

It is now my pleasure to turn the call over to Ms. Valentina Porto of InspIR Group. Ma'am, you may begin.

Valentina Porto
Thank you, and good morning, everyone. On today's call, Intercorp Financial Services will discuss its fourth quarter 2023 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. Gonzalo Basadre, Chief Executive Officer, Interseguro;
Mr. Bruno Ferreccio, Chief Executive Officer, Inteligo;
Mr. Carlos Tori, Executive Vice President of Payments at Intercorp Financial Services.

They will be discussing the results that were distributed by the company yesterday. There is also a webcast video presentation to accompany the 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 to today, please call InspIR Group in New York at (646) 940-8843.

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 future performance or financial results. As such, statements are made 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 earnings presentation and 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 opening remarks. Mr. Castellanos, please go ahead, sir.

Luis Felipe Castellanos

Thank you. Good morning, all, and welcome to our fourth quarter and full year 2023 earnings call. I want to thank you very much for attending. I want to start by making a brief summary of our strategy at IFS.

You know that our aspiration includes to become the leading digital financial services solution for clients, providing profitable products and services in our key businesses with the best digital experience for our customers based on operational excellence and leverage on advanced analytics and the best talents as our competitive advantage. This is a strategy we are deploying, and we continue to execute it with a long-term vision.

Regarding economic environment, 2023 was a challenging year in Peru with virtually no GDP growth and contraction in domestic demand, which translated into a deterioration of the payment capabilities of our retail customers. On the positive side, inflation decreased consistently during the second half of 2023, and the Central Bank has reduced the soles reference rate by 100 basis points during the year to 6.25%.

Also, expectations of a strong El Niño phenomenon have decreased and for 2024, GDP growth of around 3% is now expected, which is a good recovery versus last year.

Despite this challenging environment, IFS continues to show resilience in its core operations. In 2023, we grew our customer base and revenues, and we continue to consolidate the results of our digitalization efforts.

At Interbank, market shares across key business lines remained strong, despite moderation in consumer loans, as we are still digesting increased levels of cost of risk, mainly in the consumer finance segments. In spite of the challenging conditions, Interbank remains well-provisioned and well-capitalized.

At Interseguro, in 2023, we continued growing in premiums of individual life and retail Insurance, while consolidating market leadership in annuities. Investment results continue to be solid in the company.

Although global market conditions impacted negatively our investment results in our Wealth Management business, in 2023, Inteligo's results recovered from the negative profit posted in 2022.

Finally, on Payments, despite growth in merchants, volumes have moderated in 2023, and this has taken a toll on Izipay’s results. However, Interbank and Izipay continue working on creating synergies, while PLIN continues to accelerate with a fully interrogable P2P system.

We remain confident that IFS will continue generating sustainable returns in the coming years as we are being cautious with our operations. Given the scenario we're facing today, we continue working on our long-term strategy which is to ultimately empower all Peruvians to achieve their financial well-being.

Now let me pass it on to Michela, so she can give you a detailed review of our results. Thank you.

Michela Casassa

Thanks, Luis Felipe. Good morning, and welcome, everyone, to Intercorp Financial Services Year-end 2023 Earnings Call. Today, we will review five sections of our earnings presentation, starting with the macro-outlook for Peru.

On Slide 3, complementing what Luis Felipe mentioned, the decrease in GDP and in inflation for four quarters in a row has triggered the first cut in the soles rate, driving it down from the peak of 7.75 to 6.25, as of today. Inflation has decreased from a yearly 8.8 at the peak of June '23, to 3% as of January, already within the Central Bank's target, and exchange rate has remained relatively stable.

Twenty twenty-four is expected to be a year of recovery for the Peruvian economy with an expectation of 3% GDP growth, mainly due to the following reasons. first, the base effect versus the first quarter of 2023 as no major disruption is expected now that El Niño seems to be cooling down; recovery on public investment after the first year of the newly elected regional government; and lastly, more political stability which should positively impact private investment.

On Slide 4, we wanted to point out your attention on the latest news on El Niño. After an inflection point in the probabilities of a strong to moderate El Niño as of the end of 2023, we have started the year with very high probabilities for a non to weak Niño. This is very good news for the country as the economic recovery could speed up if no further disruption takes place in the coming months.

On Slide 5, we are providing the main operating trends for the year ending 2023, which are always in the latest guidance provided during September.

First, we continue to register sound capital levels with core equity Tier 1 ratio closing the year at 11.8% and total capital ratio at 15.5%. There has been further moderation in the yearly total loan growth to 6% as of December and 7% in consumer loans and a stabilization of NIM at 5.5%.

We continue to see good efficiency levels, both at IFS and at the bank level as we are strictly monitoring and managing costs, especially at the bank, which has reached a cost income ratio around 37% as of year-end, a strong improvement versus last year, mainly due to the good operating leverage.

Cost of risk continues to be high in consumer lending, pushing the bank year-end cost of risk to 4.3%, in the lower range of the latest guidance. IFS ROE for the full year 2023 stands at 11.3%, impacted by cost of risk at Interbank and soft investment results at Inteligo, slightly above the latest guidance.

Now, let's move to the second section of the presentation, which focuses on profitable growth. On Page 7, we see a continuous growth of customer base at IFS, or 11% year-over-year in banking, 6% in Insurance, 9% in Wealth Management and 25% in payment merchants.

On Slide 8, in line with the previously mentioned macro scenario in previous quarter, we have further moderated banking activity by tightening credit standards, which had an impact on credit and debit card purchases as well as in retail and SME loan disbursements. Reduced activity in banking and increased cost of risk in the consumer portfolio have impacted the banking earnings and ROE, while investment returns impacted Wealth Management results.

This quarter, though, we have positive news in the Insurance business, which posted solid investment results. With this, IFS earnings are at 286 million soles and ROE at 11.6% for the fourth quarter, driving the full year earnings to 1,080 million soles and ROE to 11.3%, as shown in Slides 9 and 10.

On Slides 11 and 12, good news in top line as total revenues continued to grow 4% in the quarter and 10% for the full year, thanks to the growth registering banking of 10%, Wealth Management growing more than 8x from a low base in 2022, Insurance growing 1% and Payments 5%.

On Slides 13 and 14, we wanted to give you more details on the risk profile of the portfolio. First of all, we wanted to mention that 44% of Interbank's portfolio is focused on commercial banking, which continues to behave nicely, mainly due to our conservative approach, which has always focused on low-risk clients and has had a small participation in small and micro companies. This conservative approach has allowed us to maintain a lower PDL versus our peers to balance our higher focus in the riskier consumer portfolio.

On the consumer portfolio, we have three different risks: first, the unsecured consumer portfolio, which is the one being impacted by the macro scenario and which represents 22% of the total loan book. Second, mortgages, which are also 22% of the loan book; and third, payroll deductible loans to the public sector employees, a low-risk segment, which represents 12% of the total loan book.

This quarter, cost of risk of the bank remains high at 5.2%, with retail cost of risk at 8.3%. Coverage ratio for the retail portfolio remains strong at 194% and above pre-COVID levels. Commercial Banking cost of risk has seen a slight increase with an improvement in coverage ratio.

On Slide 14, we are giving you an update of the re-schedulings in the consumer loan book. During the last quarter of 2023, these re-schedulings represent 20% of the unsecured consumer loans and have increased only 100 million soles. Payment behavior for performing loans is different for customers with re-schedulings. The unpaid portion for regular clients is only 2%, while it is around 14% for re-scheduled clients for installments matured, as of December.

Finally, on this section on Slide 15, we wanted to highlight the tight management of costs we continue to pursue, which shows a 5% decrease in total expenses at IFS for the fourth quarter of 2023 and 6% reduction at Interbank versus the previous year. With this, total expenses for the full year have only increased 2% at IFS, maintaining the efficiency ratio below 37% and has increased only 1% at Interbank, driving the cost/income ratio down more than 300 basis points to 37.3%.

Moving on to the Digital Performance section of the presentation on Slides 17 and 18, we are continuously building 100% digital solutions for our customer journey, across our businesses. We have positive news in our digital indicators, which continue to show nice trends when compared to the previous year. As of December '23, digital customers reached 75% of retail customers who interact with the bank during the last 30 days, up four points in the past year. Digital sales reached 63%, and our digital self-service indicator has improved sharply from 77% to 82%.

NPS has seen a deterioration for the first time in many quarters, mainly impacted by the actions related to risk profiling.

Insurance and Wealth Management digital indicators show positive developments as well, with digital self-service reaching 59% at Interseguro, SOAT sales reaching 82% and digital premiums

still small, but reaching 10% at Interseguro and digital transactions for fund management reaching 48%at Interfondos
Now, let's move to some more details on the performance of our four key businesses on Slides 20 to 30.

On Slide 21, we have seen 10—we have seen a year-over-year growth at the bank this quarter with net interest income growing 13%. Let me go back, sorry. On Slide 20, starting with banking and in line with our focused strategy, we continue increasing market shares, reaching 15.1% in retail deposits, 9.6% in commercial loans and retail loans at 19.1%, as of December 2023.

There are a couple of things that we have been working hard in the past months and that are bringing nice results, as shown in the market share increase to 14.7% in payroll inflows from 13.6%, one year ago, and the 17.7% market share in sales financing, up from 11.7%, just 12 months ago.

Now on Slide 21, we have seen a 10% year-over-year growth at the bank this quarter with net interest income growing 13%, coming mainly from increased volume and yield on loans, a 2% growth in fee income and 4% in other income.

On Slide 23, there has been a decrease in yield on loans of 30 basis points reaching 11.3% and NIM decreased 10 basis points to 5.5%. Risk-adjusted NIM decreased in the quarter, in line with the increase in the cost of risk of consumer loans. Good news this quarter is that cost of funds remained flat at 4.2%, as shown in Slide 24, as we start to see the first impact of a decrease in the soles rate.

Cost of funds has been rising in the past at market level, mainly due to two reasons. First, the continuous migration of retail deposits to more expensive term deposits, both in soles and dollars and the higher remuneration to commercial and institutional mainly in dollars as rates have continued to increase. Correction in overnight deposits rate in soles continues, though at a slow pace.

Our loan-to-deposit ratio of 103% is in line with the industry's average. Positive news is that the deposits continue to increase its share in total funding and that retail deposit market share has continued to increase.

Now moving to Insurance. Premiums were down 4% in the quarter, and market share of annuities was 26.4% as of November '23. Individual life and private annuities business lines continue to grow nicely quarter-over-quarter, or 6% and 40%, respectively, increasing their contribution to total premiums.

On Slide 25, the quarterly return over in the investment of the portfolio came extraordinarily high at 7.2% compared to the previous quarter, mainly due to some dividends received from particular investments. The Insurance portfolio is composed of 86% fixed income, 9% real estate and 5% equity and mutual funds, as of December '23.

Let me move now to Wealth Management. Good news in Wealth Management with the yearly growth in assets under management and 4% growth on a quarterly basis. This quarter, we saw a negative impact from investment results, but the core business continues growing. On Payments, we want to give you a summary of the developments of our payment ecosystem.

Growth in merchants in volumes continues with some moderation. Izipay merchants increased 25% year-over-year, reaching 1.3 million, while transactional volumes grew 3%. E-commerce transactions are growing at the same pace and represents 16% of our total transactional volumes as of the end of December.

In the case of Izipay Ya, our solution for micro merchants, growth in merchants was 35% and was very strong in transactional volumes or 70%, all of which are linked to an Interbank account.

On Slide 28, Izipay represents a growing and profitable operation and is working on creating synergies with Interbank. Revenues continued to grow 1% on a yearly basis and 13% in the quarter, supported by the increase in transactional volumes and merchants with some pressure on MDRs coming from increased competition.

We have seen a moderation in the transactional volume this quarter, in line with the decrease in economic activity as market share continues to increase, reaching 57% in physical acquiring and almost 24% in virtual acquiring.

EBITDA has seen a contraction in the quarterly figures, due to margin compression in a more competitive landscape.

We have been working to accelerate the growth of our payment ecosystem by having all of our assets work towards a common strategy. We are focusing on increasing transactional volumes, offering merchants additional services, continue to pilot low-risk loans to merchants and use Izipay as a distribution network for iInterbank products, as well as a source to increase float.

We are starting to see results from this strategy as evidenced by the following four key figures: 25% yearly increase in Izipay flow coming to Interbank accounts and 48% increase in average balances from merchants; 1.5x yearly increase in transactional volumes from micro merchants, thanks to Izipay Ya; and more than 5,000 new credits disbursed in our test of the new lending model to merchants.

On Slide 29, PLIN has been accelerated by the new landscape of interoperable P2P system. PLIN reached more than 14 million users as of the end of December with Interbank participation at 46%. The volume of transactions has continued its strong growth, reaching 2.4x the volume registered in the same quarter one year ago. PLIN and Yape interoperability started in April, and QR code interoperability was added in September.

This has been an important development for financial inclusion in the country, which the Central Bank has encouraged, and which should help to bring more Peruvians into the financial system, reducing the use of cash, which continues to be high in the country. Number of transactions has increased 3.3 times, since the interoperability started.

On Slide 30, moving to our ESG update, we have reinforced our sustainability strategy. Our efforts in the last 12 months have allowed us to reach 61 points in the 2023 corporate sustainability assessment with an improvement of 11 points in the environmental dimension. Moreover, we have been included in the Standard & Poor's Global Sustainability Yearbook 2024, based on our 2023 CSA score.

On the social front, Izipay Ya and our Financial Services education platform, Aprendemas, are positively contributing to financial inclusion.

On the environmental front, we are increasingly involved in green and sustainable financing by helping our customers grow their businesses in a sustainable way. Interbank has obtained a green certificate from Enel that certifies the consumption of renewable energy in 2023 at our main headquarters and has signed a contract to supply this cleaner energy, until 2025.

Now, let me move to the final part of the presentation, where we provide the guidance for 2024 and some takeaways.

On Slide 32, 2024 guidance goes as follows: first, capital ratios to remain at sound levels, with total capital ratio above 14% and core equity Tier 1 ratio at around 11%; second, a continued path to recovery towards our midterm target in core profitability with 2024 IFS ROE above 12%.

In terms of loans growth for 2024, we expect mid-single-digit growth in total loans. For 2024, we are focusing on the NIM guidance on Interbank. We expect Interbank NIM to be stable and above 5.5%.

Cost of risk is expected to remain high in 2024, above pre-COVID levels and reach a number below 4.3%, thus below 2023. It is important to remember that we included a moderate Niño phenomenon in our forward-looking variables, during the second half of 2023.

And last, we will continue to focus on efficiency, especially on positive operating leverage. IFS efficiency ratio is expected to be around 37%, one of the best in the region.

On Slide 33, let me finalize the presentation with some key takeaways. First, after a weak 2023, macro sentiment for 2024 is relatively positive with minor disruption expected from El Niño. Second, good performance in Insurance business and positive investment results in Wealth Management.

Third, retail and more specifically, consumer finance cost of risk remains high, but with strong coverage ratios. Four, tight management of costs reflected in solid efficiency levels. Cost of funds stabilizing on soles rates outlook, and we are strengthening our digital positioning and presence in Payments.

Thank you very much. Now we welcome any questions you might have. Let me only just mention that we have recently been notified that IFS has been included again in the MSCI Small Cap Index.

Now, we welcome any questions you might have.

QUESTION AND ANSWER

Operator

Thank you. At this time, we will open the floor for questions. First, we'll take the questions from the conference call and then the webcast questions. If you would like to ask a question, please press the "*" key, followed by the "1" key on your touchtone phone. Questions will be taken in the order in which they are received. If at any time you would like to remove yourself from the question queue, just press the "*" key, then the number "2". Again, to ask a question, please press "*", then "1".

For the webcast viewers, simply type your question in the box and click "Submit Question."

We will pause, momentarily, to compile our list. Thank you.

And the first question will come from Ernesto Gabilondo with Bank of America. Please go ahead.

Ernesto Gabilondo

Thank you. Hi, good morning, Luis Felipe and Michela, and good morning to all your team. And thanks for the opportunity to ask questions.

I have three questions from my side. The first one is on your cost of risk guidance. So, given that El Niño seems to have changed to a low nonimpact, how should we think about cost of risk in the first quarter of this year? You have a very strong reserve coverage ratio. So just wondering if there is a possibility that at some point in '24, we can have some reversal of provisions related to El Niño. And also, when do you expect the cost of risk to normalize to historical levels because the cost of risk for this year, above 4.3%, it continues to be high your historical levels.

Then my second question is on your NIM expectations. I want to double check if I'm correct. Can we expect NIM to behave between stable and a NIM expansion of 20 basis points, this year? And also, I would like to hear from you what should be the key drivers for NIMs in this year. I don't know if it will be the recovery in loan growth, probably more appetite on the consumer segment after leaving behind the impact of El Niño and also lower funding costs now that we are going to this easing cycle.

And my last question is on expenses. We have seen that IFS has been doing an important effort to maintain costs under control, so how should we think about OpEx growth this year? Should it be in line with inflation, a little bit above inflation? Just wanted to understand if you will continue to do investments in technology or disruptive initiatives. I also wanted to break it down on how much of the OpEx will be related to that. And also related to this question, I would also appreciate if you can share with us in which part of the P&L should we start to see the results or the benefits of all these new investments. Thank you.

Luis Felipe Castellanos

Okay. Thank you very much, Ernesto. Let me give a crack at the introduction to the answer and probably Michela will help us with a little bit more detail. In terms of cost of risk guidance, yeah, El Niño—actually, what's going on is we don't expect to have strong rains and damage to certain infrastructure due to El Niño. However, we are living through El Niño phenomenon. It's been the case for the whole most of 2023, and we expect it to continue.

As you have seen, the temperature is really high, the sea temperature or the ocean temperature is also high. So, we--even though we don't expect a strong disruption to infrastructure unless the rains that are not expected now to have been strongly due up here. No, that's something we cannot continue to rule out. The El Niño still impacts many of the industries of work in Peru like fishing, like agriculture in certain waysso even though--again, the rainfall will be more moderate or not very important. We do see some disruption there. So, we have to be careful when we talk about El Niño. Having said that, we do expect the second half to be better than the first half. And Michela will probably elaborate on that. And then on NIM, I think she also has some of the details and in general, and in terms of expenses, the only thing I can tell you that she can do some of the breakdown.

But what we know as management is that what we can control is costs, and we're very focused on that. And that discipline will continue, and it's built in two basic premises, austerity in our operations, but the second premise is we continue investing in building our future. So, we won’t sacrifice the building of our digital future for having this mindset of cost control. But do we run a very focused on austerity culture to that as you can see is giving good results in terms of operating leverage.

Having said that, let me pass on to Michela, who I'm sure will give you a little bit more detail on each of the subjects that you have raised. Thank you very much.

Michela Casassa

Hi Ernesto, thank you for your questions. Let me go in order first with your question related to cost of risk, okay? As you can see, the guidance that we are providing is to be below cost of risk of 2023. And if you see at the evolution of cost of risk during 2023, it has been going up during the third quarter and to a minor extent, during the fourth quarter. Why is that? As we have discussed in the previous conference call, specifically the consumer lending portfolio, the unsecured portion and specifically related to the fact that with no GDP growth and sustained inflation, there has been a deterioration of the payment ability of Peruvian families.

So now in the second half of 2023, we also included within the forward-looking variables of our provisions, a moderate Niño. And at the time, it was something above 100 million soles. For next year, what we are expecting is a first quarter, which is still high even with no Niño, and this is because the picking up of all the re-schedulings that we have been doing during 2023, is maturing, has matured a portion of it in the third quarter, fourth quarter, but we will still see some of that during the first quarter of 2024.

After that, we should expect--we are expecting a downward trend in the cost of risk. And to the last question of the cost of risk part not related to when should we see historical levels. I think we will not go down to below 3%, as was pre-COVID. And this is just because of the portfolio composition. Yes, we are expecting 2025 to be at a level with much lower provisions than 2024, but I wouldn't expect that number to be below pre-COVID levels.

Now, let me move to NIM expectations. We are providing a guidance of above 5.5%, relatively stable NIM. And this is because there are opposing trends within NIM during 2024. There are some positive trends and that, for sure, is related to cost of funds, specifically cost of funds in soles as rates have already started to go down. But there are also some negatives related to yield on loans, and this is coming specifically from a higher percentage from commercial loans and lower percentage in the mix of consumer loans, given that we have been decreasing the portfolio in the last months of 2023, and we expect that portfolio to continue shrinking for some months in 2024.

Okay, so putting all of that together, this is why we are giving a stable NIM expectation for 2024.

The third part related to expenses, we are giving a guidance of a stable efficiency ratio at IFS, and you know already that the efficiency ratio at IFS is particularly low at 37%. We are expecting expenses to grow mid-single digits, both at IFS and at the bank.

And specifically talking about the investments and OpEx related to digital and financial disruption, what I can tell you there, Ernesto, is that the amount of investments that we do in technology and then it's very difficult to split between what is digital disruption and what is not because at the end of the day, all the digital investments that we are doing are related to data, the app in all our strategy, which is to become a digital bank. That amount has, I mean, has become like 5x what it used to be, five to seven years ago. Now it has remained at that level and will most likely continue to grow in the coming years.

Now where in the P&L can you see the positive or the benefits of all these digital strategies that we have been deploying? I think that it is in all of the lines of the P&L because if I start to think of all the things that we have done in digital, it has boosted for sure, number of clients, but it has also boosted digital sales. So there, you can think about more income. It has boosted not only volumes because we have increased the capability to do loans, both in--more in retail, but also in fees because we have been able to do much more things in a digital way, fees, but also trading income. When we look at the penetration of products within the increased customer base, it has increased in most of the segments.

So, I would say that it is mostly related to a positive operating leverage. So, more revenues coming from all the things that we are doing in digital. For sure, there is also an impact in marginal cost because all these new clients that we have brought to the bank, but also to Interseguro, to Inteligo and merchants at Izipay. We would not have been able to do that without the digital strategy because at the same time, where we have increased 5x the digital investments, we have reduced the physical presence, more than 40%.

So, when you put everything together, I think you cannot separate and analyze only what is the impact of some specific digital initiatives, but that is the impact of the overall digital strategy that we are deploying at IFS.

And maybe just to comment a little bit more specifically on the latest investment related to Payments. There, some of the things that we are monitoring very strictly and that we are pushing for is synergies with Interbank.

So there, the play is not only the fees that already Izipay brings, but also all the synergies that we are creating in working--in making the ecosystem of Interbank stronger and attracting more inflows and float to Interbank accounts. And on top of that, with Izipay Ya, which is focused on the micro merchants, besides float and more inflows, also the possibility to start adding some new services that will provide additional fees. So let me stop there, Ernesto, to see whether I was able to answer the four questions.

Ernesto Gabilondo

Yes, thank you very much, Michela and Luis Felipe. Just a last question on your ROE. You are guiding an ROE above 12%, this year. But when should we think about your medium-term ROE? I think in the past, you were saying that IFS sustainable ROE is around 18. So just wanted to hear from you how you are seeing the ROE evolution in the next years? I understand this year will continue to be high in terms of cost of risk. But as you said, it could be normalizing to a cost of risk of 3% in the next years, that could be a driver. So just wondering how we should think about the ROE evolution, over the next couple of years?

Luis Felipe Castellanos

Sure. I think, Ernesto, thanks for your question. ROE should start normalizing, after 2024. So, I'm not pretty sure that Michela can tell us, according to our models, 2025 will already be there, but we'll be targeting that 18%, medium term. So hopefully, we'll be able to reach that. It's all related to the performance of the economy.

And we have done our work in terms of changing the profile of our new customer acquisition in terms of credit cards and consumer loans. However, it has to react according to how the economy goes in the future. So, our base case is that starting 2025 will be returning to higher profitability levels. And obviously, we have to pay close attention to the investment results, and that will be subject to the evolution of the international capital markets. I don't know, Michela, if you want to complement something else.

Michela Casassa

Ernesto, I mean, the cost of risk is not necessarily going down to 3%. It will go down to below 4%, but not necessarily 3.0. It's somewhere between 3%, 3.5%, I don't know exactly. And in 2025, I mean, we could get back to the midterm ROE in 2025. Actually, the uncertainty there is if the bank goes back to the '17 to '18 ROE and that will depend on the speed of the recovery of the Peruvian economy, which directly impacts the consumer portfolio.

Ernesto Gabilondo

Okay, excellent. Thank you very much.

Operator

Again, if you have a question, please press “*”, then “1”. Our next question will come from Nicolas Riva with Bank of America. Please go ahead.

Nicolas Riva

Thanks very much, Michela and Luis Felipe, for taking my question. So, I have a question on your Tier 2 bonds, the ones issued at the Interbank level at the bank level. So, the bank already announced that you guys are going to be calling the outstanding of the 2029 Tier 2s in March, just over $100 million. But you also have another Tier 2 bond that you can call next year. The economics are quite different from the ‘29, it’s a lower coupon and lower reset. So, if you can discuss what we should expect regarding the call option on the 2030 Tier 2s next year?

And then also, earlier this year, to finance the call on the '29s, you issued a tenant call 5 Tier 2 bond. And that's also like a legacy Tier 2 in the sense that there's no coupon deferral and there's no CET1 trigger for principal ride. My question is why does the bank regulator in Peru allow banks to issue--to still issue these legacy Tier 2 bonds, rather than Basel III Tier 2s? Thanks.

Luis Felipe Castellanos

Thanks, Nicolas. That's a perfect question to be answered by Michela. Go ahead please, Michela.

Michela Casassa

Hi Nicolas, thank you for your questions. Listen, first, related to the Tier 2 that will mature or will be callable during next year, it's something that we are expecting to renew for sure. We do need the additional $300 million of debt for our total capital ratio. And as why the superintendency allows banks to issue all style bonds, that—we don't know the exact why. But what I can tell you is that, you know, Peru has been for a long period of time in a stage that we always described at Basel 2.5.

The latest regulation that was issued during last year brought us to Basel 2.95 to say it in some way. And the only feature that has not been implemented is the one that you're asking. So, everything else has been aligned to Basel III, but the Tier 2 bonds have remained with those characteristics.

So basically, the one that we issued in January is an old style which, at the end, is pretty liked by the investors. And we are not sure really whether or not there is going to be additional regulation going forward. But if not, most likely, the new that we will issue next year will also be in this way, unless there are news in the regulation.

Nicolas Riva

Okay, understood. Michela, One follow-up on the Peru comment, when you said we need the $300 million Tier 2 capital from the 2030 if we expect--you mean in that sense, you mean that you expect to call that bond and to replace it with a new legacy Tier 2 issuance?

Michela Casassa

I mean, we will need to evaluate, of course, on the economics, but which we will need to be closer to the call date of the bond.

Nicolas Riva

Okay. And just one last question on that. If you were not to call that bond, does it start losing capital treatment?

Michela Casassa

Yes. Yes. Yes, it does. 20% per year.

Nicolas Riva

Okay, thank you very much, Michela.

Michela Casassa

Thank you.

Operator

The next question will come from Carlos Gomez with HSBC. Please go ahead.

Carlos Gomez

Thank you very much for taking my call and thank you, Michela and Luis Felipe. I joined late, and I may--you may already have answered this, but can you tell us your views about the level of indebtedness of the SMEs and the consumers in Peru? And what is a realistic outlook for credit growth, not only for this year but for the coming two or three years? And second, during the COVID pandemic, you tried to make a push for SMEs through the Reactiva program. Where do you stand there, and do you have more ambitions to grow in that segment? Thank you.

Luis Felipe Castellanos

Okay. Yeah, thank you, Carlos, for your question. The level of indebtedness--let me take a crack to answering your question in two fronts. The first one, there's still lots of room in terms of increasing bancarization in Peru on the debt sector, okay? So, I think we're still stand at 40% total loans over GDP and consumer loans are well below that.

So, the growth potential for the Peruvian system remains as strong as it has been in the last years. Obviously, we are undergoing a negative credit cycle right now given economic conditions and the overall environment, but we know that will pass and growth will return, moving forward. And if that is coupled with the recovery of the economy, then growth will be even stronger. And the same happens for SMEs. I think one of the things in SMEs is the informality in Peru is an issue in order to be more aggressive. And so, we are working on building the capabilities and analytical capabilities to get to them.

The push thet we did during the pandemic working with Reactiva, was very positive for us, it allows us to learn very much about our clients in a segment that we are not really big. However, given current macro environment, we are not there in terms of taking additional risk, we are very aggressive, if you want, in our retail portfolio.

We don't need to be--to do that in our commercial portfolio that SME, as well. So, we have a solid 3% market share. We are building the capabilities and analytical capabilities to serve that market. And we’ve learned a lot. And we see what's working with them. However, until the cycle does not turn around, we’ll probably remain in our conservative approach towards SMEs.

The Izipay acquisition has put us very close to merchants, and that creates an avenue of growth for our customer segment that the company knows very well. And as Michela mentioned, we are already seeing this year. So, we have new assets in terms of data crack at that segment without disproportionate increase in risk levels. I think that's--from my side, I don't know, Michela, if you want to complement something.

Michela Casassa

The only thing I would add is that from all the new clients that we started working with during the Reactiva loans--in the small business segment, okay, we were not able to lend to many of them. I think it's somewhere below 15%, the percentage of loans that we were able to renew, without the guarantee of Reactiva. But what was really positive news from that was that the number of clients increased substantially in that segment. and also, the float with that segment, so deposits. And together with those deposits, fees coming from transfers and also trading income.

So, there was a side business coming from that segment with the Reactiva program. And when we move upwards to the midsized company, there, the impact was even higher. We were able to replace Reactiva loans there. I think it was around 40% or something like that. And also, the collateral business, trading income in fees was very important.

And I think that that, together with some other things that we have been doing in the mid-corporate segment, has allowed us to reach the #3 position in the market, as of year-end. We used to be #4; now we are #3 in the market.

Carlos Gomez

Thank you. You say your market share is—did I understand 3% or 13%?

Michela Casassa

No, in the small business, it's only 3%.

Carlos Gomez

In the small--but that is small business, that's not the SMEs, right?

Michela Casassa

It’s a portion of both the mid-corporate plus small business, yes.

Carlos Gomez

Okay. And I think my other question was in terms of actual numbers, yes, there is a lot of principal growth. How much will you expect your portfolio to grow again, not only ‘24, but also ‘25, ‘26?

Michela Casassa

In that specific segment, sorry, or overall?

Carlos Gomez

Both.

Michela Casassa

Okay. No, what--I mean, the guidance that we are giving for total loan growth for next year is mid-single digit, okay. Actually, we are expecting a little bit higher increase in loans in commercial banking and a little bit lower in retail banking because, still, the consumer portfolio I mean, will grow marginally, we believe.

Carlos Gomez

Thank you so much.

Operator

At this time, we will take the webcast questions. I would now like to turn the call over to InspIR Group. Please go ahead.

Valentina Porto

Thank you, Operator. The first question comes from Daniel Mora of Creditcorp. In 2024, can we expect a stable NIM given that with the increases in rates, it remained stable at 5.5.

Michela Casassa

Let me take that, Daniel. Thank you for your question. I guess we commented on that before. Yes, we are providing guidance for a stable NIM, which is the result of decreasing cost of funds from the cuts in soles rates but also some pressure in the yield on loans, due to the portfolio mix in its evolution.

Valentina Porto
Thank you. And as a follow-up to that, when do you expect to reach the peak in provisions and the peak in nonperforming loans?

Michela Casassa

Peak in provisions, I mean, we believe that the high quarters, I mean, have been already in the third and fourth quarter, but the first quarter of 2024 is still going to be a high cost of risk for the consumer portfolio. After that, we expect cost of risk to start to go down and, eventually, normalize in the coming quarters.

Valentina Porto

The next question comes from Nancy Lopez of UP. What was the main trigger of a change on retail loans to more expensive maintenance ones?

Michela Casassa

Can you read it again, sorry?

Valentina Porto

What was the trigger--main trigger on retail loans to more expensive maintenance ones?

Michela Casassa

To more expensive maintenance ones? Is that the question?

Valentina Porto
Yes.

Michela Casassa

I mean, maybe if I can comment on the portfolio mix. What has been happening in the past two quarters is that consumer loans, the unsecured portion, has been decreasing because of the risk profile. That is the main reason why, while we have seen continuous growth in mortgages, in payroll deductible loans to the public sector employees and also in commercial banking.

Valentina Porto

The next question comes from Daniel Merida of PUCP. Good morning, thanks for the presentation. Can you please give an update about your buyback program?

Michela Casassa

Sure. The buyback program was put in a hold, a few months ago. Actually, after the latest update that we gave during, I think it was three quarters ago. We have not pursued any additional purchases. And it is in kind of a wait-and-see position, given that we are now focusing more on maintaining the capital levels given the macro-outlook that changed dramatically during the last half of 2023.

Valentina Porto

The next question is from Ernesto Gabilondo of Bank of America. How should we think about the dividend payout ratio this year?

Luis Felipe Castellanos

Hi Ernesto, I think you can hear me now. I'm sorry, I had some problem with my microphone. Well, it's basically our policy, you have to take into account 45% of the bank, I think like 50% of the Insurance company and a bit of the Inteligo which results are not very high. Then we'll take some cash into the operating company to--sorry, to the holding company in order to cover expenses and debt service. So, it should be--I think we're announcing it pretty soon.

So, you can work through the numbers. As you know, I don't know if we can tell the number right now, we still have to go through the process of IFS Board and the shareholders' meeting to approve it. But that's the way we build up our dividends. And it's based, remember, on local ones. So, I worked through the numbers, but it's too early to actually mention it., but probably, we'll have a dividend. So that's good news.

CONCLUSION

Valentina Porto

At this time, there are no further questions. I'd like to turn the call over to the operator.

Operator

Thank you. There appear to be no further questions at this time as well on the audio side. I would like to turn the floor back over to Ms. Casassa for any closing remarks. Please go ahead.

Michela Casassa

Okay. Thank you very much. Thank you, everybody, again, for attending our call and for the questions, and we'll see each other again for our first quarter results. Thanks again. Bye-bye.

Operator

This concludes today's conference call. You may now disconnect.