Intercorp Financial Services

Q4 2020 Earnings Conference Call

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CORPORATE PARTICIPANTS

Luis Felipe Castellanos – *Chief Executive Officer*

Michela Casassa – *Chief Financial Officer*

Gonzalo Basadre – *Chief Executive Officer of Interseguro*

Bruno Ferreccio – *Chief Executive Officer of Inteligo*

PRESENTATION

Operator
Good morning, and welcome to the Intercorp Financial Services Fourth Quarter 2020 Conference Call. All lines have been placed on a mute to prevent any background noise. After the presentation, we will open the floor for questions. At that time instructions will be given as to the procedure to follow if you would like to ask a question. Also, you can submit online questions at any time today using the window on the webcast and they will be answered after the presentation during the Q&A session. Simply type your question in the box and click submit question. It is now my pleasure to turn the call over to Rafael Borja of i-advize Corporate Communications. Sir, you may begin.

Rafael Borja
Thank you, operator, and good morning everyone. On today's call, Intercorp Financial Services will discuss its Fourth 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 video 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 in New York at (212) 406-3693.

I would like to remind you that today's call is for investors and analysts only. Therefore, questions from the media will not be taken.

Please be advised that forward-looking statements may be made during this conference call. These do not account for the future economic circumstances, industry conditions, the company's future performance, or financial results. As such, the 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 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
Okay, thank you. Good morning. First, I want to thank everyone for making the time to attend our call. I hope all of you and your families remain healthy and safe during these challenging times. As you are aware, Peru continues to struggle from the effects of the pandemic. After an improvement in the number of cases by the end of the year, we now face a second wave that has overloaded our health system and the number of cases and fatalities continues to rise. As a result, by late last month, the government announced new lockdown measures, being more strict in certain regions including Lima. As of now, we know those measures will be in place at least until the end of February and our expectation is that they will continue for some more days after that. However, unlike the past lockdown, the new restrictions will likely have a more moderate impact in the economy since most businesses are allowed to operate at least partially.

Good news were announced recently. The vaccination program has already started, and the country has finally secured an important number of vaccines from different companies that should reduce effects of the pandemic on the months to come.

Moving on, despite the health situation, the economic activity is gradually recovering. The recovery is mainly driven by more activity in domestic demand-oriented sectors. We foresee a strong recovery in 2021 mainly due to better terms of trade, higher private consumption, and the base effect when compared with 2020. Obviously, the effective control of the pandemic will be directly related to the economic performance of the country.

An element of uncertainty continues to be the political landscape. Presidential and congressional elections will take place in April. At this point, it is hard to tell who has higher probability of being elected. On the congressional front, certain populist measures continue to be proposed or debated. Some of them, such as the interest rate cap proposal or the integrated universal pension system bill, may impact the financial system. Different institutions have made public statements against this initiative and the executive branch has found relief in certain rulings by the Constitutional Court. We will continue to closely monitor the evolution of political news in the coming months.

In this environment, banks have continued to help Peruvians to overcome the crisis by offering payment relief to individuals and companies. At system level, gross loans grew 12% year-on-year as of December, driven by a 23% increase in commercial loans, mainly boosted by the Reactiva Peru program. However, retail loans at the system level decreased 3% on a yearly basis. Deposits continue to grow strongly. At IFS, our platform continues to show a strong resilience and has recovered nicely from a very low second quarter 2020. The trend we saw in the third quarter has continued with a strong activity at Inteligo and Interseguro.

Interbank continues to see an improvement in all of its main operating and financial indicators. We expect this trend to continue with a very strong capital base, a world class level efficiency, and levels and digital solutions and services that continue to gain preference of our customers. We continue to be focused on helping our customers during these times and to deploy our resources in an efficient way to maintain the path for profitable growth.

Now, let me pass it on to Michela for a detail review of our results. Thank you again and please remain safe.

Michela Casassa
Thank you, Luis Felipe. Good morning, and welcome everyone to Intercorp Financial Services fourth quarter and full-year 2020 earnings call. This time, we have divided the presentation in four parts, which include financial highlights, key messages, results by segment and trends and takeaways at the end.

I will start with a brief summary of financial highlights on Slides 3 to 6. Main highlights are: At IFS, the profitability recovers in the fourth quarter with a return on adjusted equity at 18.1%. Full year results have been impacted mainly by higher provisions at the bank. 15.6% earnings growth in the fourth quarter due to lower provisions, solid results from investments, and recovery of fee income. Cost containment measures in 2020 offset negative impacts from COVID-19 on revenues. We have strong capitalization at all business segments and the digital trends continue to support IFS strategy. At Interbank, profitability recovers in the fourth quarter with the full year profits undermined by high provisions and soft top line due to COVID-19. A 24.6% earnings growth in the fourth quarter, due to lower provisions and fee income recovery. We have a 12.8%

market share in loans and 13.9% market share in retail deposits by year end, having gained 20 basis points in loans and 40 basis points on a yearly basis in retail deposits. NIM continues to have pressure on it, decreasing 40 basis points in the quarter, still impacted by Reactiva loans and the portfolio mix.

We have 150 basis points yearly reduction in cost of funds, down to 1.6% in the fourth quarter. The full-year cost of risk is at 6.1%, but strongly improving in the fourth quarter to 3.1%. We have a 60-basis point quarterly improvement in NIM after provisions, due to the decrease in cost of risk. Moreover, we have a 7% yearly decrease in expenses in the bank with an extraordinary low efficiency ratio at 31.4% at IFS level.

At Interseguro, full year 20 profits grew 8.2% with return on adjusted equity at high levels at 18.9%. Private and regular annuities leading a 19.1% yearly growth in premiums, results from investments strong and increase 13.1% on a quarterly basis and 28% on a yearly basis with return on the investment portfolio reaching 6.8% in the fourth quarter. The cost containment measures at Interseguro resulted in 4.3% yearly reduction in expenses and we continue to be the market leader in annuities with a 27.3% share in 2020.

At Inteligo, the full year profits grew 21.4% with a return on adjusted equity at 28%. Record quarter in earnings, 40% quarterly growth and more than two-fold on a yearly basis. Strong revenues in the fourth quarter driven by net interest income and positive mark-to-market. Continued growth in asset under management of 5.6% in the quarter and 14.7% year-over-year, and an ROE at all-time high in the fourth quarter.

One of the good news this quarter is that the top line has continued to recover with adjusted total revenues for IFS growing 0.5% in the quarter and 6.4% year-over-year driving the yearly growth to 5%. This is mainly thanks to a recovery in most revenue lines including net interest income, fees, and other income. This recovery has taken place in all three operating companies with fee income growing 6.5% in the quarter for Interbank, and a strong result of more than 100 million Soles in other income at Inteligo.

Now, I will focus on the key messages we would like you to take home from this call on Slide 8. There are 5 key messages, which we will cover in detail in the following slides: first, activity has continued to recover in all three operating companies, despite macro and political uncertainty. Second, we have a strong balance sheet with liquidity and capital levels substantially better when compared to pre-COVID levels. Third, the digital trends continue to support IFS strategy, which translates into growth of clients and business. Fourth, lower provisions continue to reflect better payment behavior of clients. And fifth, our continued focus on efficiency in each of the three operating companies has allowed us to decrease our cost base and improve our efficiency ratio in such a difficult year.

The first key message on Slides 9 through 11 is about recovery in activity. Economic activity in Peru has continued to increase from the low levels registered in April. During the second quarter, we have seen one of the strongest negative impacts of GDP in the region, declining 40% in April, 32% in May, and 18% in June. The positive news is that this last quarter, we have continued to see a recovery already started in the third quarter in a number of indicators, such as the mining and fishing GDP as well as cement consumption, some of which show strong level of growth year-over-year.

Moreover, electricity consumption as of January has just been published showing a positive 1% year-over-year and 5% for the Lima region. Expectations on economic activity are still on positive ground. Total loans to the private sector, as mentioned by Luis Felipe grew 12% as of year-end mainly driven by Reactiva loans. Excluding such effect, total loans decreased 4.6% with retail decreasing 3% and commercial loans, excluding Reactiva, decreasing 5.5%.

On Slide 10, monthly operating trends at IFS have continued to show positive developments in activity for 4Q 2020 as well as for January 2021. At Interbank, debit and credit cards turnover has recovered to pre-COVID levels reaching a peak in December at 113%. New disbursement of payroll deduction loans to the public sector employees are growing 11% versus pre-COVID level, while mortgages are growing 9% after a peak in December of +22% versus pre-COVID levels.

Total fees for Interbank are at 83% of pre-COVID levels with commercial banking fees recovering faster than retail fees after a low 48% level in April. In the case of Interseguro and Inteligo, their recovery has been much faster with gross premiums in January of this year at 121% versus pre-COVID levels and assets under management at +12% in January versus last year. This faster recovery was reflected in the yearly earnings of both companies of growing 8.2% and 21.4%, respectively.

Moving to Slide 11, as previously mentioned by Luis Felipe, new focalized lockdown measures have been implemented from January 31st to February 28th, yet not as restrictive as in 2020. The state of emergency has been extended until February 28th. Few activities have been restricted, and we have mobility restrictions across the country. The government has put in place some additional measures to face the second wave, totally already around 20% of the Peru's GDP, one of the most important support programs in the region, which includes additional cash transfers of 4.2 – to 4.2 million households, cash transfers to workers under the Perfect Suspension Scheme, additional $2 billion for SMEs and additional grace periods and duration of Reactiva Loans.

On the political and regulatory agenda, populist initiatives continue to be debated in Congress including interest rate caps proposal, integrated universal pension system bill, among others. The constitutional court has already stopped three of these potential laws in the past month. Finally, 2021 presidential and congressional elections show little clarity as to which candidate could be the next president.

On Page 12, during the fourth quarter we have continued to see an increase in our total deposit base at Interbank of 4.8%, driving the yearly growth to reach 25%, which has helped our loan-to-deposit ratio to stand at 93%, below the system average. Moreover, the loan to deposit ratio in both currencies is at healthy levels with a loan to deposit ratio in soles of 106%, well below the 117% of the system as a whole.

There has been an improvement in liquidity in the financial system due to the funds coming from private pension funds as well as the unused portion of the funds coming from Reactiva Peru loans. We have been able to benefit from the situation and to have gained 40 basis points market share in retail loans during the year.

Moreover, we have ample liquid financial assets with PEN 26.7 billion at Interbank, out of which PEN 17.7 billion are cash and equivalents and have around PEN 950 million at IFS stand-alone level, out of which more than PEN 380 million are cash and equivalents, which could cover IFS current obligations for more than three years.

On Slide 13, we have a solid capital position at all three operating companies of IFS. Since the beginning of COVID, we have taken important measures to strengthen our capital. Our total capital ratio as of the end of September was 17% at Interbank compared to 15.4% of the system and the minimum 10.7% required by the SBS. This means that we have over 600 basis points buffer in our total capital ratio.

Our core equity Tier 1 ratio was 11.5% this quarter, which is 10 basis points above the third quarter ratio. At Interseguro, our solvency ratio stands at 165%, well above the 100% required; while at Inteligo, our capitalization ratio is 28%, again, well above the 8% required.

Moving onto the third message on Slide 14. Our digital KPIs continue to show positive trends, supporting IFS strategy. As a result of the lockdown and our efforts to boost the use of our digital solutions, we have seen an acceleration of our digital indicators. Digital users as of December are 75% of our customer base, up 12 points from one year ago. 100% digital customers, which are clients that do not use branches or contact center any longer and who use digital channels, plus ATMs and correspondent agents only for cash-in and cash-out, have reached 58%, up 26 points from one year ago. These have helped us accelerate our branch rationalization efforts, allowing us to close 40 branches during 2020 and reducing our total branch network by more than 25% since our peak in 2016 and more than 15% during 2020, down to 215 branches.

Digital sales have also seen a rapid increase. At Interbank, retail digital sales reached 51%, and at Interseguro, SOAT digital sales reached 81%, both increasing sharply from one year ago.

We have continued to see an important number of new digital accounts being opened for individuals. As of the end of December, 55% of new retail saving accounts were opened digitally. New digital client acquisition of retail customers reached 44% compared to 22% one year before after a peak of 65% in June this year. Our investments to build our digital capabilities during the last years have definitely played to an advantage for our customers and our operations under the current circumstances.

On Slide 15, we have reached 4 million retail customers and more than 100,000 businesses at Interbank. Our retail client base has increased almost 15% on a yearly basis, while our commercial client base has increased 46% year-over-year.

PLIN, the P2P payment feature among multiple banks operating with cell phone numbers, is already active in more than 2.9 million clients as of January in only one year, 39% of which used Interbank as key account.

Tunki, our 100% digital solution for payments relaunched on February this year -- last year sorry has reached almost 800,000 as of today.

On Slides 16 to 17, the fourth key message refers to the lower provisions registered during this quarter, thanks to the continued improving payment behavior among our customers. There are three positive trends that we have seen during this quarter in line with what we saw in the third quarter.

On Slide 16, the first positive trend is that outstanding rescheduled loans have slightly decreased. As of December, outstanding rescheduled loans were PEN 10.5 billion or 25% of the total loan book, in line with the system. This number represents an 11% decrease versus September and 17% versus June. This is true for both retail and commercial portfolios. Moreover, the number of total clients rescheduled has also decreased as the new inflow has been marginal during this last month, including January.

On Slide 17, the second positive trend is that we are seeing an improving payment behavior among Interbank clients. As of January, 99% of our retail portfolio has already had a payment due, this means only 1% is still in grace period. 63% of the retail portfolio has not been rescheduled and is registering a very good payment behavior. 98.5% of clients are paying their installments, only 0.1% has requested an additional relief, and only 1.4% have not paid. Summing up, new requests of relief and not paid, this represents a 1.5% as of January, which compares to 2.1% as of October.

Of the 37% of the retail portfolio, which has been rescheduled as of January, 96.2% of clients are paying their installments, only 0.5% have requested an additional relief, and only 3.3% have not paid. Again, summing up, new relief requests and not paid, this represents a 3.8% as of January, which compares to 7.4% as of October. A similar payment behavior has been observed for credit cards as of January, with the percentage of payments at almost 98% for the 49% of the portfolio that has not been rescheduled, while almost 98% for the reactive reschedulings, 95% for unilateral rescheduling, and around 92% for structural reschedulings.

As for SMEs is concerned, the outstanding rescheduled portfolio is small at around PEN 750 million, out of which 93.8% of clients have been paying their installments out of the 94% that have had payments already as of the end of January.

On Slide 18, the third positive trend is the quarterly reduction of provisions. Cost of risk for the quarter was 3.1%, which compares to the 13.4% of the second quarter and the 4.5% of the third quarter 2020. Looking at the yearly cost of risk, total cost of risk was 6.1% compared to 2.6% in 2019. As for retail is concerned, quarterly cost of risk was 6.2%, down from 23.6% in the second quarter, and 8.5% in the third quarter, but still above the 4.8% of one year ago, driving the yearly cost of risk to 11%. Commercial banking continues to have low levels of cost of risk, thanks to our small participation in the SME segment, and was 0.5% in the quarter and 1.2% in the year.

NPL coverage for the bank as of December is at more than 180%, and for retail loans is at more than 200%. Our stock of provisions as of year-end represents 8.6% of our total loans, excluding Reactiva guaranteed portion of loans.

Finally, the last of the key messages on Slide 19 refers to the disciplined and proactive management of costs we have pursued before and after COVID started, which has allowed us to achieve an important reduction in cost of 5%, when compared to the previous year, and to improve our efficiency ratio at IFS and in each of the operating companies. Efficiency ratio at IFS is extraordinarily low at 31% with Interbank's at 36.8%. These good and improving efficiency ratios are the result of a disciplined approach to expenses throughout the company.

As an example, we have continued to implement our branch optimization program started in 2016, which I previously mentioned. Moreover, we have some variable costs related to credit card activities and to incentives that have decreased substantially during this year, in line with the lower activity, but one additional thing that we did right after the COVID outbreak in the beginning of the lockdown in Peru was to launch a very important cost containment program in all operating companies, in order to decrease the cost base to partially offset the negative impacts on top line coming from the lockdown.

Now let's have a closer look at some additional indicators by segment in Slides 20 to 30. On Slide 21, we are showing our key banking indicators. NIM decreased 40 basis points in the quarter, down to 4.4%. This decrease in NIM was related on one side to the portfolio mix with retail loans decreasing in the quarter and on the other side to Reactiva Loans at low yields. Impact from

Reactiva loans on NIM was around 50 basis points in the quarter. Total other income continued to grow in the quarter, mainly driven by an increase of 6.7% in net fee income due to a recovery in transactional volumes, especially in credit cards.

Other expenses grew 3.2% in the quarter, when excluding the PEN 35 million impact for additional profit-sharing expenses, which correspond to voluntary loan loss provisions in local accounting standards, which have not yet turned into regulatory provisions, thus are not tax deductible.

This expense will be recovered during 2021 as voluntary provisions in Local GAAP turn into regulatory provisions. 4Q expenses were still below the fourth quarter 2019, when excluding this effect, and cost containment measures remain in place.

On Slide 22, our year-over-year loan growth was 12%, mainly thanks to the Reactiva loan disbursements. The positive news here is that both mortgages and payroll deductible loans to the public sector ended up the year in positive territory growing 6.6% and 0.4% respectively.

Commercial banking grew 34% in the year, but decreased 1.6% in the quarter. Total retail loans decreased 2.4% in the quarter and 6.9% in the year, driven by an 11% and 26% contraction respectively in the credit card volumes. During this quarter, we continued with a conservative approach towards growth in this portfolio, given the shock experienced in the income of Peruvian families.

The strong growth in commercial loans together with a softer reduction in the retail portfolio than the system, has led to an increase in our total loans market share of 20 basis points in the year, reaching 12.8%.

On Slide 23, we have started to see some prepayments of Reactiva Loans in the corporate segments. As of the end of December, we have outstanding PEN 6.6 billion in Reactiva loans, which have boosted our commercial loan book by almost 40% since the first quarter 2020. Most of these loans have been granted to the mid-sized and SME businesses, increasing our portfolios 68% and 200%, respectively, between March and December.

On Slide 24, total deposits grew 4.8% in the quarter and 25.3% in the year with retail deposits growing 6.4% in the quarter and 30% year-over-year, gaining 40 basis point market share to a record 13.9% as of December. Due to banks, which include the Central Bank's funding for the Reactiva Peru program, has decreased 8.4% quarter-over-quarter but has increased threefold on a yearly basis in line with the funds we have lent to our clients. Cost of funds has continued to improve, reaching 1.6% in this quarter, a reduction of 10 basis points in the quarter and 150 basis points year-over-year. This positive development came from several factors like decreases in market rates, a better funding mix, and the higher funding from the Central Bank. Additionally, the yearly contraction was also due to the redemption of an expensive Tier 1 bond in April.

On Slide 26, we wanted to share with you something that in this very challenging year has brought a sense of pride to IFS employees, which is the fact that for the first time ever Interbank has been awarded the three most renowned prizes as Best Bank of the Year 2020 by The Banker, Euromoney, and LatinFinance. This is just a confirmation that we are on the right track and pushes us to continue to focus on our purpose of helping more customers to accomplish their dreams today.

Now, turning to Interseguro on Slides 27 and 28, quarterly premiums showed a strong growth in the quarter of 32%, driving the yearly growth to 19%. In the fourth quarter, all business lines grew with mandatory and private annuities leading the growth in premiums. Interseguro remains market leader with a 27.6% market share in this quarter.

On Slide 28, Interseguro investment portfolio reached almost PEN 14 billion, a 6% increase on a quarterly basis and 12% on a yearly basis. Results from investments had a strong performance, increasing 13% on a quarterly basis, reaching a 6.8% return on Interseguro's investment portfolio, 100 basis point above the fourth quarter 2019 level.

Moving to the Wealth Management segment on Slide 29, Inteligo posted record revenues in the fourth quarter, explained by a positive mark-to-market of more than PEN 100 million accounted in other income, which grew 42% on a quarterly basis. This improvement in other income has led to an increase in total revenues at Inteligo from PEN 102 million in the fourth quarter 2019 and PEN 140 million in the third quarter 2020 to PEN 188 million in the fourth quarter 2020.

On Slide 28, Inteligo's assets under management reached PEN 21 billion in the fourth quarter, a 5.6% quarterly increase and 14.7% increase on a yearly basis. Thanks to the strong growth in the top line, Inteligo's net profit of PEN 155 million was more than 2 times those from the fourth quarter 2019, which allowed the company to post a growth in earnings of more than 20% on a yearly basis.

Now let's move to the final message related to trends and takeaways. On Slide 32, we are providing some operating trends expected for 2021. We have to take into account that some new restrictions have been implemented in Peru to face the second wave of COVID as previously mentioned and we are not sure today about the length and impact these measures will have as it will depend on the progression of the second wave and the speed at which people will be vaccinated. 2021 will be a year of rebuilding the portfolio at Interbank to foster growth in the coming years. Interseguro and Inteligo should continue to grow, despite an extraordinary good year for both companies in 2020 despite COVID-19.

First capital, we expect Interbank capital to remain at sound levels, well above regulatory requirements with total capital ratio above 15% as of year-end and core equity Tier 1 ratio above 11%. In terms of IFS return on adjusted equity, it should recover and be above 14% for 2021 and should continue to recover in 2022, once we are able to rebuild the retail consumer portfolio and replace a bigger portion of Reactiva Loans.

Third, loan growth at the bank for 2021 will be mild with a slow recovery in retail, especially in the consumer portfolio and decreasing volumes in commercial. When excluding the impact of Reactiva Loans, the total loan book for the bank should increase mid-single digits.

Revenues will also have a soft recovery due to pressures on net interest income and NIM, despite lower cost of funds and a strong recovery of fees at Interbank. NIM will most likely continue to decrease in 2021 and be between 4 and 4.3%. The pressure in net interest income and NIM is mainly coming from three factors. First, the full year effect of almost PEN 7 billion of Reactiva Loans at very low rates. Second, the impact of mix on average yields due to the decrease in the credit card portfolio and the increase in mortgages. Third, the decrease in rates.

Cost of risk will be at a low level of around 2%, even below pre-COVID levels of 2.5% to 2.8% as most COVID-related provisions have already been accounted for in 2020 and also due to the lower share of the credit card portfolio, which is the product with the highest cost of risk. This number will most likely increase during 2022 as the credit card portfolio recovers and gains share within the total loan book.

IFS efficiency ratio will be between 35% and 37%. After a 5% reduction in the total cost base of IFS this year, we expect a high single-digit increase in expenses, mainly due to two reasons. First, the recovery of activity, which drives variable costs, and second, further acceleration of our digital investment, including building our venture with Rappi.

On Slide 33, we wanted to share with you some developments on sustainability. You can see how we have strengthened our ESG practices and initiatives in recent years. We acknowledge that our stakeholders are increasingly evaluating ESG factors, when assessing companies. Hence, we are adopting stronger and widespread ESG practices as a predominant driver of value creation not only for shareholders, but for all stakeholders over the long term.

Some of the achievements in the environmental pillar include recycle and waste management efforts. In the scope of social impact, we encourage diversity, equity, and inclusion where we have developed a number of strategic alliances and programs towards these goals. As to our corporate governance practices, we highlight the longstanding majority of independent directors in our Board, the highly supervised related party exposure and strict compliance policies. Furthermore, IFS is one of 9 Peruvian companies included in the Lima Stock Exchange Good Corporate Governance Index. Additionally, IFS stock was recently included in the MSCI Peru Investable Market Index.

Finally, on Slide 34, I want to close the presentation with a brief summary of the 5 key messages. First, activity has continued to recover in all 3 operating companies despite macro and political uncertainty. Second, we have a strong balance sheet with liquidity and capital levels substantially better, when compared to pre-COVID levels. Third, the digital trends continue to support IFS strategy, which translates into growth of clients and business. Fourth, lower provisions continue to reflect better payment behavior. And the final one, our continued focus on efficiency in each of the 3 operating companies has allowed us to decrease our cost base and improve our efficiency ratio in such a difficult year.

Thank you very much. Now, we welcome any questions you might have.

QUESTIONS AND ANSWERS

Operator
Thank you, and we will now begin the question-and-answer session. First, we will take questions from the Conference Call, then the webcast question. If you would like to ask a question, please press star (*) and then 1 on your touch tone phone now. Questions will be taken in the order that they are received. If at any time, you would like to remove yourself from the queue, by pressing star (*) then two (2). Again, to ask a question, please press star (*) then one (1). For the webcast viewers, simply type your question in the box and click *submit question*. If you ask your question via the phone, we kindly ask that you mute the webcast to prevent any feedback. We will pause momentarily to compile our list of questioners.

Our first question will come from Jason Mollin with Scotiabank. Please go ahead.

Jason Mollin
Hi, good morning everyone. My question is on the retail segment portfolio and we appreciated the disclosure of the payroll deduction loans to the public sector employees, that looks to be a lower risk part of the retail portfolio. Can you talk about this business in terms of how – the dynamics, how it works, is there turnover in the employees, the duration of loans and of course

how you see the risk there and in fact if it is much lower than the other parts of the retail book? Thank you.

Luis Felipe Castellanos
Yes, Hi Jason, it is Luis Felipe here. Thanks for your question. Sure, as you are aware of it. It is basically payroll financing -- the only thing that instead of – as you know we are not that big in payroll deposits in the private sector. That market is very interesting, but we do not have a big position there. And so, we do have a strong presence in the public sector employees, and that business has been evolving and as any payroll deductible loan, it has lower risk than just normal cash loan, no? The turnover in the public sector is low, so specifically during the pandemic, it has not been affected as we have seen in the other types of business, and the duration of the loan is a typical loan in retail of consumer loan – like around 3 to 4 years in terms of tenor.

Jason Mollin
And I mean it looks that it is representing almost a quarter of the retail loans and even a higher percentage of consumer loans. We saw with the decline in credit cards, I mean should this percentage I guess if credit card loans return this would go down but, or if is this a business that has been relatively stable, do you see potential growth in this segment of payrolls?

Luis Felipe Castellanos
Yes. Again, the dynamics of the way like the payroll for the public sector increases is not as active as the private sector. Obviously, in terms of when we see like a crisis like we had last year, obviously it is more stable, but also the growth is not that important. So, what we see is that when credit card recovers, this portfolio will return, on a weighted average if you want, based to return more to previous levels. You have to remember that our credit card portfolio has basically decreased by close to 25%, similar to what has happened in the system. So, obviously just by that -- this weighs a bit more but then we should return to more normal levels once the other parts of the business start recovering.

Jason Mollin
And are these loans, are they at much lower rate than your traditional book and I am imagining the loss is -- what would the expected loss be in this segment?

Luis Felipe Castellanos
Yes, I would not say they are at a much lower rate, it is at an average rate, but they do have because of the payroll deductible portion a lower risk, no? Similar to what you see in the private payroll deductible loans.

Jason Mollin
Thank you very much.

Luis Felipe Castellanos
You are welcome.

Operator
Our next question will come from Ernesto Gabilondo with Bank of America. Please go ahead.

Ernesto Gabilondo
Hi, good morning Luis Felipe and Michela, Gonzalo and Bruno. Thanks for the presentation and for the opportunity. My first question is on loan growth. You mentioned in your presentation that you are expecting slow recovery in retail and decreasing volumes in commercial loans, although

what would imply in terms of total loan growth, you see mid-to-high single-digit growth? And then, for my second question, can you elaborate a little bit more on how are you getting an ROE above 14% in 2021. Clearly, this will come by reducing provisions with cost of risk of around 2%, and this could be offsetting NIM pressure and a weaker efficiency. However, what other lines do you expect to be supporting the earnings growth and the ROE above 14%? Thank you.

Luis Felipe Castellanos
Okay. So, for both questions, let me pass it on to Michela, so she can help you with that.

Michela Casassa
Good morning, Ernesto. Thank you for the questions. I mean on loan growth, okay, what we are seeing is a slow recovery of retail, okay, and when excluding Reactiva, we are seeing also a slow recovery of commercial loans. So basically, putting everything together but always excluding Reactiva, we are guiding for a mid-single digit, so no to the mid-to-high single digit that you are asking, okay. Because we are talking about around a mid-single digit for retail and something close to that when excluding Reactiva.

As far as profitability is concerned, I would say that I mean the stronger contributor for sure is cost of risk, the decrease in cost of risk is very strong for 2021 and as the revenue recovery will be slower. Within revenue, what we are seeing is a recovery of fee income no? And this is just also because of the base effect. Also, we're seeing fee income at Interbank, but also at Inteligo growing nicely for next year and that should also help profitability. So, I would say no -- first place and most important provisions, and second, I would say a fee income as the second contributor.

Ernesto Gabilondo
Perfect, thank you very much.

Operator
And our next question will come from Sebastián Gallego with Credicorp Capital. Please, go ahead.

Sebastián Gallego
Yes, Hi, good morning everyone, thanks for the presentation. I have some questions today, three questions today. The first one probably a follow-up on previous questions on the consumer portfolio. You mentioned that there will be a slow recovery on consumer portfolio, but can you go a little bit deeper on the timing as we move through the year. When do you expect a ramp up or material increase or recovery within the consumer and particularly credit cards? The second question will be related to the SME portfolio. You mentioned, you provided some data on the recovery and the payment behavior, but could you clarify, once again, how is that payment behavior going for SMEs? And finally the third question will be on Inteligo and Interseguro particularly taking into account how sustainable are these types of results that we are seeing in those companies? Thank you.

Luis Felipe Castellanos
Okay, thanks for your question, let me take a crack on the first one and comment on the third one, but I will pass it to Michela for the second one.

The consumer portfolio – let's see, it obviously is related to the recovery of the economy. We have been actually on the conservative side, especially last quarter. While the industry is already getting some traction there, we are still being very conservative in our underwriting standards because we – basically because what is happening in all over the world, we knew a second wave was coming. So, we have not returned to growth and we keep like observing the customer behavior. What we are seeing, which are good news, is a recovery of activity, people are using more like debit and credit card for payments. However, they are also paying more, and they are paying in time, and that, as Michela mentioned, coming better than expected.

So, if the economic growth and the internal demand materializes as we expect and we ourselves feel more comfortable, we will gradually be returning to growth. However, we are still on a wait-and-see attitude, obviously serving our existing customers, but our underwriting standards continue to be stringent, if you want, obviously not at the same levels as we had before in the midst of the pandemic, but we are taking it carefully on this sight. So, that is on the first question.

On the third question, and maybe after Michela, Bruno, or Gonzalo would like to complement, but again, Inteligo and Interseguro, we have been doing this like year in and year out, no? The nature of the business, this is the business we feel very comfortable with. We are leaders in market share in terms of obvious [unintelligible] Inteligo has been growing steadily for all the recent years and obviously we are part of like a financial group that is very focused on investments -and investments, you know better than no one, have like a different evolution.

Inteligo had a tough first quarter last year, however, if you are consistent and you are disciplined, all in all, the result will come and that is what we have shown for many years so far already, with an unpredicted future, but obviously the team is there and we have all the capabilities to continue that.

Let me jump, let me pass it on to Michela for question number 2 about SMEs portfolio and what we are seeing in the recovery process.

Michela Casassa
Yes. As for SMEs is concerned, what I mentioned previously is that I mean we have a small portfolio, okay. It is around PEN 750 million now and it has been decreasing. Out of this portfolio, 93.8% of clients have been paying their installments as of January and 94% have already had payment due as of January. So only 6% of our SME portfolio as of January was still on grace period, okay. So, the behavior is like good and actually has been improving over the past month. What is true, and I think it is worth mentioning that most of these clients also received last year a Reactiva loan, also that has helped them to cope, with a shortness of working capital that they could have. So, as months go further with the new restrictions, now some sectors of the SME portfolio that are more related to tourism and transport, maybe entertainment, could have a further hit, but we have estimated that this -- a small portion of this portfolio, which is already has a small incidence in our total loan book.

Sebastián Gallego
Okay, thank you and if I may -- maybe one last question, I was forgetting to ask about the CTS and the decision of the Labor Commission of the Congress to approve the availability of 100% of CTS. Do you guys expect any material effect if this is approved in the deposit market or this shouldn't be as relevant as other regulatory risks or initiatives?

Luis Felipe Castellanos
Yes, Hi. It is hard to tell, no? Now, first the project is in the early stages and we have learnt through all this time that this has a long way to go, usually. We have heard that again the executive does not think this is a good decision. So, it has some battleground there in terms of the legislative side before it materializes, but obviously, probably it will have an impact if people decide to retire. We have been under this before because if you remember there have been many

times when first there were like free – a part of your CTS, then from six-month salary, I don't recall, but then to 4-month salary, and we have seen that. At the beginning there is an impact, which stabilizes pretty quick. Those anyhow are not – the rates for CTS are a bit higher, so it will have an offsetting result. But obviously, given the situation, if CTS decides to be liberated, probably many people will access that; however, at least for the Interbank side of funding, it is a very small portion. We only have like around 10% market share there, so it's not – it will have an impact, but it is not that relevant. Again, it is early to tell and I think that with the liquidity that we have in the system and the available sources of financing for the industry as a whole and for Interbank, and IFS in particular, it shouldn't be an issue from that -- from a liquidity perspective.

Sebastián Gallego
Thank you very much. Very clear.

Gonzalo Basadre
I wanted to get back on the question about the sustainability of Interseguro's and Inteligo's results. The Interseguro's ROE for the fourth quarter, I believe, is totally sustainable going forward. We are seeing very high interest in our products from our customers. So, we don't --- we don't see any -- we don't have any worry about our topline growth. Our only worry would be financial markets. If there is any turbulence over there, then surely that will affect our portfolio, but that should be temporary, right? Long term, I think that our ROEs levels for the fourth quarter will be a good proxy for companies going forward.

Sebastián Gallego
Great, congratulations.

Luis Felipe Castellanos
Okay, thank you Gonzalo, and maybe a couple of words from Bruno.

Bruno Ferreccio
Yes, it is similar to what Gonzalo is saying, the business was very stable last year, even though it was a very hard year, but we saw a nice growth on wealth management, so we think those trends are going to continue. On the market side, it is very similar to Interseguro. There is going to be some volatility, but we have a medium- to long-term view on our portfolio. And so, we look at this on a rolling basis -- rolling 12-month basis if you could say -- say that way, not on a quarterly-quarterly basis, there is some volatility there as Felipe mentioned the first quarter was tough. Third and fourth quarters were very good, but on 12-month rolling basis, it was a -- it was a very nice performance and that's what we look for in the long term to have a balanced portfolio and returns over time. Hopefully, we are going to continue the same way that we have seen on today's date. So, ROE for the year we think we can maintain our target as we could in the previous years.

Sebastián Gallego
Thank you very much.

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

Carlos Gomez
Hello, good morning and thank you as always for your detailed presentation. Two questions. First, in terms of your provisioning effort, I mean, you mentioned you already have more than 8% of non-Reactiva loans covered. Do you have the sense that you might have provisioned too much

or you are just about right? -- what you expect already normal provision for this year? Would you say that given the experience of payments that you have that you may actually be below normal for the next couple of years?

The second refers to the Reactiva loans. In the past you have mentioned that the actual life of the loans is not the three years maximum, but a shorter period, could you give us an update about the life of the Reactiva loan portfolio and whether you expect to be able to eventually transfer that to loans with normal rates? Thank you.

Luis Felipe Castellanos
Okay, let me give it a crack and then I will pass it to Michela to complement. On your first question about the provision levels, actually, again, remember that this is all very new for everybody like what we have seen with the pandemic, distortion of all the models that everybody had, not only like IFS, but also, we have seen that throughout the world and the region. So, we all went on the conservative front and actually, we have not returned to normality. We have seen that improved behavior to what our expectations were, however, we are, as mentioned, facing the second wave, which we see as not having that strong impact as the first wave and the lockdown that we had, but it is too early to tell. We don't know how many more days, months, or how will the pandemic evolve. So, that will be very dependent. So, although we are seeing a better payment behavior, as Michela will mention in during her presentation, we still see levels of uncertainty, so I wouldn't feel comfortable, I—maybe Michela can complement in saying that we are completely done.

I think we have -- based on the first wave, we feel comfortable that they are well covered, but the extent of what is there to come still unknown. With the numbers we have upfront, we have given our guidance of what we think is going to happen in the portfolio. We are very confident that we will reach those levels; however, any excess will be covered, but we have what we had already done.

And then for the Reactiva question, before passing it on to Michela, the tenor continues to be the same. There are some efforts from the government to see if there is going to be changes in any specific industry – apparently it is not going to be for the whole program, but probably for the sectors that are the most impacted, that may have an extension of the three-year tenor, and what we are seeing is that some companies are already repaying the loans. That is why the original tenor of the overall Reactiva portfolio is coming down, because we are seeing prepayments, because as you know, it is a very restricting program where companies cannot invest in like CapEx or in distribute dividend, so whoever, whatever company feels that the worse is behind and they have another sources of liquidity, they are repaying, but let me pass it on to Michela, so she can complement how do we expect this can be repriced and maybe any comment on the first part of your questions.

Michela Casassa
Thank you, Felipe. Let me just to add on the point of provisions that, yes, we took a conservative approach, especially when we implemented the provisions in the second quarter with the expert criteria. And basically, what we have seen is slightly better payment behavior in the third and fourth quarters versus what we expected would happen, no, and what we base our level of provisions. Now, in theory, the forward-looking variables before we knew about the second wave, the forward-looking variables to update the model would have resulted in maybe lower provisions, no? Because the forward-looking variables, macro variables were improving, before the second wave. But basically, we have not updated them just because the second wave was starting. So, the second wave already was going to hit those variables, no? If you want, we have kind of a slightly conservative approach this quarter, because there are some provisions that if there is an

impact from the second wave, we could be covering with what we have been doing during this year. Not so, of course, it will depend on the length and the severity of the second wave, but if the behavior, the payment behavior of clients does not change dramatically, I guess we should be okay with the guidance we gave.

Then as far as the Reactiva, the duration -- just to add that the repayments that we have seen so far, are only focused or mainly focused on the corporate segment, okay. When you see the SMEs and the midsized companies, very little repayments there. It is mostly the large corporate segments and the duration of that segment specifically will most likely recover, but for new loans to the mid corporates and the SMEs, I mean, the level of rates of those loans that are not Reactiva related are similar to what we had pre-COVID and are based on the risk adjusted profitability. Of course, in the large corporate segment is a little bit more difficult, because large corporate clients tend to request a lower rate, but that is not the case of what we will see in the mid-sized companies and SMEs.

Carlos Gomez
And the average duration at this point is how much?

Michela Casassa
It is -- I mean it is the same that we have had; it is around 2.5 years.

Carlos Gomez
2.5 years to go, okay. Thank you very much for your detailed answer.

Michela Casassa
You're welcome.

Operator
Our next question will come from Marlon Medina with JP Morgan, please go ahead.

Marlon Medina
Good morning, team. Thanks for the opportunity to ask questions. The first one is related to the rate cap bill. In particular, what are your expectations for the next steps and for timing? We know it was returned to Congress last week but, what is going to happen next and also do you have any expected impact from this bill if it is approved? And my second question is just your outlook for dividend payments in 2021 and 2022? Thanks.

Luis Felipe
Okay, thank you. On the bill, well the process is as follows: the executive branch has observed it and they came back to Congress with a very detailed explanation of what were the observations. To summarize it, most of them were around the constitutionality or the crush with the constitution in terms of the way it is prepared, so now Congress has the law and is looking at the observations. It is probably going to be addressed by the Economic Commission -- which is a commission that did not look at the law before, surprisingly it was waved from that commission, it was a surprise for everyone, but apparently it is going back there.

Also, I know that the Constitutional Commission has asked to review it, because I guess, Congress is being more careful in terms of these constitutional crushes because, as Michela mentioned, already a few times, three of those proposed laws set by Congress have been declined or disapproved by the Constitutional Court, so they are going to be very careful about that.

Our expectation is that it might change based on these observations, we don't know the extent of the changes, maybe it is left aside, but if it goes approved by insistence, which is something that Congress can do, what we feel -- based on the track record, we think that the executive branch will go to the Constitutional Court in order to not allow this to happen, no? So basically, that is where we stand – that's what we are expecting. So, it's still early to tell if you want based on the very recent event that happened around the law.

Then, in terms of the effect and again, the main effect of the cap will – the way it is written is that it will give the Central Bank, that as you know is a very technical and professional institution in Peru, very admired, not only in the region, but around the world, which is the one that will be required to put the cap rates actually, the limits. So, understanding the way they think, probably it should not have a strong effect, however, we are going through congressional elections and the Central Bank at the end should remain very stable. But that is the real risk, that sometime in the future that discipline gets lost and the changes occur. So, we don't really expect in the short-term even if it is approved to have a material effect on the rate itself. There are other like commissions that were thrown upon in the project, but that might have an effect, but those are still being observed under the same terms. So, again, we have some time here in order to see what will be the end effect and the real effect of all this, but we are confident that, as we've seen in the other cases, this will be managed in a very responsible way. So, basically that is all from my side.

Michela Casassa
Yes, maybe, I just -- I just wanted to complement a couple of numbers, even if Luis Felipe already mentioned, we still don't know what is going to happen, based on some first analysis on how much of our retail or the bank portfolio could be impacted by this law, I mean we do not have a large portion of the portfolio in high yields, which are the ones that want to be regulated. Actually we are talking, I mean it is like less than 3% of the total loan book of the bank could be impacted or less than 5% of the retail portfolio. So basically, let see how -- if this is approved and in what terms, but it should not be such a big impact in terms of interests and yields.

Marlon Medina
Thanks, that is very clear and what is your outlook for payout in the next years?

Luis Felipe Castellanos
Oh, dividends, well again, we will, like this year, we need to see but we will – again we will try to return to our normal policies that we had except Interbank. So, we do expect this year to be a very low dividend based on that Interbank has been hit hard. We did not have earnings and whatever we did in the local books, which are the ones that define the dividend payout, we have capitalized 100% already of those earnings for 2020, but then for next year and the following years, we are expecting to return to the previous levels and continue with our pre-COVID dividend payout policy.

Marlon Medina
Very clear, thank you very much.

Operator
Our next question will come from Andres Soto with Santander. Please go ahead.

Andres Soto
Good morning and thank you for the presentation. My first question is regarding your ROE guidance. When you say above 14%, can you please break that down for your different business -- Interbank, Inteligo and Interseguro?

Luis Felipe Castellanos
Michela?

Michela Casassa
Yes, yes, I am here. Hello Andres, thanks for your question. I mean basically, what we are expecting is the level of - starting for Interseguro and Inteligo. Interseguro to be, as Gonzalo mentioned, in levels above 15%. Inteligo, again, should be in levels above 20%, and the one that will still be in its recovery phase is Interbank. So, basically Interbank is the one that is still in -- like the mid double-digit area for this year, and that should improve as long as the top line continues to improve, because the cost of risk is already at better levels than before. So, I guess that -- that will be more or less the composition of each segment driving towards the 14% plus.

Andres Soto
Perfect, thank you Michela, and when you say Interbank is still on a recovery path, you mean that by 2022, it should return to the previous pre-COVID level of ROE or have you seen any structural change on the profitability level, not only for Interbank, but for any of your businesses?

Michela Casassa
I mean, actually to be sincere, we are not sure yet whether 2022 is going to be 100% recovered, okay. Because one of the things that is impacting the return on equity of the Interbank is the portfolio mix, okay. So basically, today we have a mix in which commercial have taken more weight and mortgages have taken more weight, because the credit card portfolio is the one that has been strongly hit by the pandemic. So, we are seeing -- we are expecting a recovery this year but still the share of credit cards will be low when compared to the pre-COVID levels ending this year -- and during 2022. It will recover, it will continue to recover, but we are not sure yet whether as to the levels before COVID. So, I guess it is a matter actually of the speed of the recovery, of the mix of the portfolio that will drive that recovery in ROE for Interbank.

Structural changes, I mean we are in a context of low interest rates, so basically that is also impacting NIM for sure. We have been able – in any case as we have shown to improve the efficiency ratio, etc., but at some point in time, the rates should start to recover and not sure whether that is going to be 2023, but also all the things that we are doing in digital are helping the , if you want -- I mean the future recovery of earnings because of the client base. So everything put together, we should be able to reach, I mean, I am not sure if 100%, but close to pre-COVID profitability at the bank.

Andres Soto
Sure, that is the very clear answer. Thank you, and my second question is regarding the new round of reprogramming that the government is promoting. I would like to understand if you guys intend to offer this facility or are you planning to, you know, you see of the need in your portfolio for clients to have this type of benefit or you believe that this is not going to be relevant at this time around?

Luis Felipe Castellanos
Sure. I think there is a little confusion here, because of the headline by Gestion today. What the Superintendency has issued recently, is nothing else that extending what they had already issued

at the beginning of the pandemic, basically granting the financial institutions the ability to provide relief, basically. So, I think the headline is a little bit misleading in terms of the way it is written.

So, that is good news because the Superintendency is extending the flexibility under certain -- with certain changes that has had for months to come. If you remember there was a law passed by Congress that allowed the government to grant some guarantees targeted to loans -- consumer loans below PEN 10,000, and that is a program that is active, actually Interbank is participating under that program. So, you can reduce interest rates for certain amount, and you will get a guarantee by COFIDE basically in order to do that. So, the universe of people that can get to that level has not really resulted in lots of customers coming to seek for that, it is really - has had no impact yet. And I guess, when we were talking about the team and looking at the numbers, we have done massive reprogramming already. What we have done at least from the Interbank perspective is more than 450,000 of our retail customers and a big number and we have extended the terms of the obligations up to 80 months in some cases, 80, eight, zero, reducing rates and giving grace periods. So, what we did that actually hit us really hard last year in terms of results but was what we needed to do in order to help Peruvians, that has been massive. So, what we are seeing now is that the volumes of people coming back to us for new facilities to reprogram their loans, it is very, very small.

So, that is the way we are looking in it. Again, it will depend on the extent of the lockdown and how long it takes to recover from the pandemic in order for us to come to better conclusions. However, as also has been mentioned during the call, we do not see that the economic activity has been hit that hard compared to what happened last year. So, we are still optimistic in terms that this economic activity not being hit so hard will not result in massive reprogramming as was highlighted today in that newspaper.

Andres Soto
Perfect. Thank you, Felipe, and, regarding the retail loan guarantees that you also mentioned in your response. How much of your portfolio is currently represented by those, so called refinanced loans? Given that the program was extended through March 31st, how much additional of this program can you have in your book, you know this could be another source of pressure in your NIM, so it will be interesting to see how much of this NIM pressure for this year related to this program? Thank you.

Luis Felipe Castellanos
Yes, under that program, I would say nonmaterial so far and unless something changes, we don't see that increasing significantly. So, that specific portion would not have an effect in our results.

Andres Soto
Perfect. Thank you so much.

Luis Felipe Castellanos
You are welcome.

Operator
Our next question will come from Maria Cruz with Seminario. Please go ahead.

Maria Cruz
Thank you for the opportunity to ask questions and I do not know if you have talked this before. I want to know, because I just read the news about the SBS setting new conditions for a new massive loan rescheduling program. And so I think you just talked about that, right?

Luis Felipe Castellanos
Exactly.

Maria Cruz
Okay, so there is not going to be any impact, because you mentioned that already many people applied on these programs, right?

Luis Felipe Castellanos
Yes, but what basically what the news really says is that the Superintendency has extended the relief that institutions had in order to provide these re-programming or this relief to customers, no? the conditions. So, it is basically extending that for more time. Again, with certain thres. But it is not that they have launched any type of new program. It is basically given the flexibilities for institutions in order to have refinancing programs in order to face the situation. Last time, which they were enacted in March 2020, it was actually massive, but again we have been working with our customers throughout the year to accommodate their new situations and as mentioned now more than 450 thousand customers have already accessed to that, we have seen that the payments are coming in according to the schedules, so we expect with the information we have now that to continue in the near term.

Maria Cruz
Thank you very much.

Michela Casassa
Maria, just to add some numbers that we have shown already, but putting in perspective, no, the total reprogramming that we have done already under the different formulas, as of today, they represent 25% of our total loan portfolio. They reached 31% as of June and when we look specifically, at the most impacted portfolios like retail and SMEs, in retail, at some point we reached 43% and actually the percentage in the consumer loan book, so credit cards, was above 70%. In the case of SMEs, again we are talking about that, I do not know, more than 3/4 of our SME clients, the small businesses were reprogrammed. So, I guess like a massive portion of clients related to consumer loans, and small businesses loans have already been rescheduled under one of the different schemes that were implemented.

Luis Felipe Castellanos
Yes, and moreover just to close on this topic, we do have our landing page for reprogramming open and any customer of Interbank can go in and look for different type of alternative solution. The thing is that the volumes of people coming in to look for that, is very small so far and we hope that it will continue that way. But if customer of Interbank requires assistance, we have an offer for them in order to help them cope throughout this period.

Maria Cruz
Okay, thank you, thank you very much.

Luis Felipe Castellanos
You are welcome.

Operator
Our next question will be a follow-up from Jason Mollin with Scotiabank, please go ahead.

Jason Mollin
Thank you, just to wrap a lot of the topics commented on. I thought one thing I wanted to hear from you is with the potential pension reform, what is the linkage and how do you view that the impact for your annuity's business? And then, you were mentioning the fact that interest rates are low and there are implications in this environment for NIM, I mean, there seems to be some headwinds and challenges for the banking system or financial system in Peru in the current context. And I am just thinking about looking longer term beyond 20 -- definitely beyond 2021, but may be 2022, 2023 or 2024, but when we think about returns, how can we conservatively try to address these issues of caps and pension reform and low interest rates and bank's abilities to manage this. What do you think are the key drivers for a bank like IFS to go back to pre-pandemic profitability? Thanks.

Luis Felipe Castellanos
Okay, thank you Jason. First let me pass it on to Gonzalo, so he can address that question about the pension plan reform and the impact on the annuity business. Gonzalo please.

Gonzalo Basadre
Sorry about that. There are two kinds of annuities. Disability and survivor benefits annuities, which we call the regulated annuities, and the private annuities. Disability and survivor annuities are funded through the disability and survivor insurance that all workers or all legal workers or formal workers pay in Peru or deducted from their salary every month. It goes to -- it is insured through a syndicate of insurance companies, which we currently don't operate. And if the worker dies or becomes disabled, then that insurance pays a lump-sum and with this lump-sum the person or the beneficiaries buy an annuity with an insurance company like us. That part of the business is, in the new plan that has been discussed, it would be taken by the government. So, that part of the business would no longer be available for private insurance companies. The other part of the annuities' business is what we call the private annuities, which is people with their own savings that come to us and they buy annuities for a fixed period of time or for life. That part of the business is, it's part of that comes from what people retire from their AFP's accounts and part with their own savings. Right now, the project is not mandatory. I mean, it's, people will decide if they want to join the state-sponsored savings plan for retirement. So, we see, on this second part, we see much less effect on the new regulation. Still, we think that that the most probable outcome is that this new law won't be passed. There is a lot of opposition from workers, who don't want to lose their money or give their money to the State -- for the State to manage it. So, in summary of the two annuities businesses, the disability and survivor benefits would be affected, the private annuities will be much less affected, but in general, we think that the most probable outcome is that the law won't pass.

Jason Mollin
That is very helpful. Just in terms of defining the size of that government sector -- or that government segment that is at risk, what does that represent the earnings today?

Gonzalo Basadre
Remember that this will only -- this will only apply for new annuities right now, I mean the annuities we sell don't generate any earnings to us right now, they will generate throughout the years, so the earnings of Interseguro are the results of all the annuities we sold before, not the annuities we have just sold today, right? What I can tell you is that this represents around half of what we sell on the annuities part of our business and that would mean that our business would -- the growth of our business will be reduced in a significant part, right?

Jason Mollin
Understood, I understand, thank you very much.

Luis Felipe Castellanos
Okay, thank you Gonzalo, and Jason, going through your second question, we can have a long talk about this, but let me summarize a couple of points. Obviously, there is some pressure on regulation, but we really don't know the outcomes, okay. So, and we don't know what is going to really happen in terms of regulation, obviously. We believe we still operate in a country that the macro environment is one of its strengths. We expect that to continue. The regulatory framework overall continues to be strong. The SBS is a very good regulator and the Central Bank has proven, again as mentioned, that has the right policies. So, that is the overall environment. Obviously, there are some pressures there, but the outcome is very hard to say.

But one of the big trends here, Peru continues to be underpenetrated in terms of financial services. This has accelerated a bit with the pandemic, but we see that the overall investment thesis of a country that requires to expand financial services. It remains there with, again, a stable macro framework and very well-regulated industry. So, those fundaments continue to hold, and we expect that it will continue in the future with the pressures probably being offset -- or will have to be offset, and that depends on the strategy of each organization with a drastic jump to the digital, which is what -- the way we are addressing these pressures. And as Michela has mentioned, we have been gaining in terms of preference for our digital solutions and we expect that to continue. We are investing heavily in transforming the bank and also in building new ventures in order to be able to address those opportunities that we see in the future. So, the profitability of the system should continue to be strong, given the requirement of investments being physical or digital that have to be done, especially in bringing more people into the system. So, I don't know if I address your question properly, but those are the thoughts that come to mind when talking about medium, long-term prospects for financial services in Peru.

Operator
Now I would like to turn the conference over to i-advize for any webcast questions now.

Rafael Borja
Thank you, operator. We have a couple of questions from the webcast. The first question comes from Juan Dominguez from Onyx. We think your strategy with Reactiva Peru is appealing, as it provides you an opportunity to learn about the SME segment, assuming a low credit risk. What have you learned so far about the behavior of this segment? How much are these clients demanding other products of the bank? SME credit still has a lot of human touch, especially for risk assessment. How will you see your sales platform for this segment evolving after the effects of Reactiva Peru start to fade?

Luis Felipe Castellanos
Okay, thank you very much for your question. Yes, you are right that -- that was irrational. Again, we have been always, let say very shy in terms of SME, and we saw Reactiva as an opportunity not only to help Peruvians but also -- because that's the real view we had from this was an opportunity to help many Peruvians that are suffering. So we went to get a lion's share compared to what we originally had, but also an opportunity to learn more from this segment with a low risk, as was mentioned. We are in the process, obviously we have expanded significantly our number of customers and that helps us to improve our both commercial and risk models. And I agree that this has a human touch, and we will try not to lose it, but that the way we see the opportunity here is again more of a digital approach towards so customers and retailizing the risk evaluation. We have proven that we have strong skills in risk management for consumer and retail. So, we are

building models in order to translate some of that knowhow into the SME business with an enlarged customer base and by learning more from a more diverse base.

So, that is the opportunity still in the process. All the initial indicators prove that we have – that our thesis could be right in the future, and in terms of what other things we have learned, yes, people see SMEs maybe as opportunity just to grant loans, but we are seeing that savings for those customers or clients are growing and cross selling of certain products related to cash management, collections are coming in. So, it's not only credit type of business for us, but we are pursuing a more holistic and complete view towards the level of service that we can provide to them. I don't know Michela if you want to add something else also on that.

Michela Casassa
No, I am not, I am fine, thanks.

Luis Felipe Castellanos
Thank you for question.

Rafael Borja
We have one more question from Piedad Alessandri from Credicorp Capital. Hi, I wanted to ask regarding the charge-offs in the 4Q. Are those loans related to this year's pandemic or are those related to earlier loss?

Luis Felipe Castellanos
Yes, let me pass it on to Michela.

Michela Casassa
Here I am. Actually, the fourth quarter charge-off is like -- there has been an increase compared to the previous quarter, but actually that is like a catch-up, because as the loans were frozen due to the measures from the Superintendency, there were not many charge-offs in the second and third quarter of the year, okay. So basically, when you look at the total number of charge-offs that we have during 2020, it is similar to the 2019, which is low, given the COVID impact. Also, most of those are related to COVID, or a big portion of them, but the biggest portion of the charge-offs will materialize during 2021. So, basically, we have already done the provisions, but the charge-offs, we will start to see to a bigger extent, we have seen already in this fourth quarter and we will continue to see high levels of charge-offs in the quarters to come.

Rafael Borja
At this time, we have no further questions, I would like to turn the call over to the operator.

Operator
Then this actually will conclude our question-and-answer session. I would like to turn the conference back over to Ms. Casassa for any closing remarks.

CONCLUSION

Michela Casassa
Okay. Thank you very much. Thanks again for everybody for the time in this call, and we will see each other again at this time, not only listen, in the first quarter results of 2021. Bye, everybody.

Operator
The conference is now concluded. Thank you for attending today's presentation. You may now disconnect your lines at this time.