Q4 2013 Earnings Call

Company Participants
• Nuno Manuel da Silva Amado
• Miguel de Campos Pereira de Bragança
• Rui Pedro da Conceição Coimbra Fernandes

Other Participants
• Benjie Creelan-Sandford
• Carlos Peixoto
• Ignacio Ulargui
• Juan Carlos Calvo
• Antonio Ramirez
• Mario Ropero Garcia
• Roberto C. Casoni
• Jaime Hernández

MANAGEMENT DISCUSSION SECTION

Operator
Good day and welcome to the Millennium bcp Full Year 2013 Earnings Conference Call. Today's conference is being recorded.
At this time, I would like to turn the conference over to Nuno Amado, Vice Chairman and CEO. Please go ahead, sir.

Nuno Manuel da Silva Amado

Good afternoon, everybody. As it was mentioned, I am Nuno Amado, the CEO of the bank. I will make a brief summary introduction on the results and some comments, and then I will pass the floor to Miguel Bragança, our CFO.
I'm going to page four of the presentation. In page four of the presentation, we have stated highlights of the year for our bank and we put it in three areas: capital, profitability and liquidity. In terms of capital, we reached 13.8% ratio, capital Tier I ratio according to the Bank of Portugal rules, and we have also reached 10.8% of capital ratio according to EBA, and if we take in consideration the sovereign buffer, I believe, 2011 sovereign buffer if we don't take that in consideration, our EBA ratio would be 12.8%. So, we have reinforced our capital ratios basically through reduction of our RWAs, as you will see later on.
In terms of profitability, our net income was a loss of €740 million Euros, which represents, obviously, an improvement vis-à-vis previous year in which we presented a loss of €1.2 billion. However, I have to tell you that these are difficult results, as you know. But I have to tell you also that these results are in accordance with the plans that we have signed with DG Comp, what we call restructuration plan. We are, just to give you an idea, in the boundary of 5% minus or less vis-à-vis as planned. So, we are very close to the plan that we agreed basically in June, July last year.

We have some difficulties on net interest income related with the level of interest rates and the CoCos. However, as you will see later in the presentation, we have a progressive improvement of our core income, we have some green shoots in this area, still small but let's see how it will develop during 2014.
An important issue on the year and on the last quarter was the agreement that we got, the pre-agreement that we got with the unions for the implementation of the restructuration plan. We have agreed on a temporary reduction of salaries around in – an average of 6%. And with this, we will improve, obviously, our capability of being under the target that we have agreed also with DG Comp. And this is, I think, very good news. It's, I believe, the first time that this pre-agreement was reached on a so large scale. Our bank has almost 9,000 people in Portugal, and that I think is a good new in generic terms.
But that implies that we booked, also as agreed with DG Comp, an extraordinary provision amount for restructuration in the amount of €126 million Euros. This cost, this extraordinary cost was, as I mentioned, included in our plan, but in our plan it was considered in 2013 and 2014. So, we have anticipated a little bit the 2014 impact, and we have booked it in last year.
Taking in consideration what are the recurrent cost, the ordinary costs, we got a reduction in Portugal of about 15%, more than €130 million Euros of cost reduction in Portugal, as you'll see in detail.
Our NPLs, also the new entries in Portugal decreased, and they were, last year, more or less half of the amount that they were in previous year and the second semester was better than the first semester on this respect. And I think that will give us the opportunity to have a sustained reduction of the cost of risk, I, say a sustained reduction in terms of ordinary cost of risk. However, in what we call, or what is the total level of provisions, provisions for credit or impairments for credit and other provisions for other costs and other risks, we have maintained, I would say, a high level as you'll see in the P&L, the total amount was larger than €1.2 billion, so, lower level of entries, still a high ratio as normal for this situation, the situation of Portugal and we maintained in this year, last year, a high level of provision which I think was the best thing to do taking in consideration our judgment on the bank and on the evolution of the credit portfolio.
In terms of international operations, we are also in accordance with the plan. We got a net income of our international operations of €178 million Euros. As you'll see, a very large contribution from Poland, Mozambique and Angola, and then an increase of 6.5% in credit last year.
In terms of liquidity, we continued the reduction of our commercial gap. This was done through the two issues. This is an increase of deposits and a decrease of loans. And our net deposit – loan to deposit ratio reached 117%, which is already below the recommended level by the central bank, Bank of Portugal, of 120%. And if you take in consideration what is net loans not only to deposits but to customer balance sheet funds, this ratio already reached 108%. So, we already reached the level that was in our plan for 2015.
We have increased, as mentioned, the deposits, and that increase was in the level of 5.2%, 4% in Portugal. We have focused also in – start to lend to companies – start to lend to Portuguese companies. I would say that it is not correct. We are focusing to lend to Portuguese, Polish, Angola, and Mozambique good companies.

However, the key issue is Portugal for the reason that you understand, and here we have – and we are focusing on that in spite of some reduction of the total credit portfolio that is related with the dynamic of the demand in offer that we will explain later on. Our reduction of the ECB decreased to €10 billion. It was a little bit larger than €12 billion in September, and now it is around €10 billion.

In page five, we have the graphic presentation of what I mentioned to you, and I would like only to make a very brief consideration here. This is total customer deposits, as I mentioned, increased for 5.2%, but with a very good and a very strong increase in both foreign international operations, 8%; Portuguese operations 4%, so a very good mix.

On page six, as you can see, the core income of the bank is increasing, still in a low level because of the reasons that I mentioned, basically, the interest rate and the CoCos cost, but increasing quarter-on-quarter, and we hope that this trend, we can get this trend during this year, let's see the first and second quarter of the year that I think the most difficult ones as – at least, as we expect it.

Operating cost, the amount that I mentioned, less €130 million Euros of cost in Portugal is a lot and we still have the requirement based on the agreement with DG Comp to reduce this figure and we will reach this figure, the figure agreed with DG Comp. The rest is what I already mentioned.

So, and before passing the floor to Miguel Bragança, I think, despite the difficult macro environment, that is improving, let's say this very clearly, there are some signs of recovery in both the macroeconomic, as you know with two quarters in a row with positive GDP, or in the bank, if we take in consideration the evolution of the core income, small but constant, and the new NPL entries that are decreasing, the amounts that we are having in this concept. So, despite the difficult macroeconomic environment, there are signs of improvement.

For us, this year, 2014, is a critical year. We have to keep the engine of the profits that we get from our international operations in a growing and sustainable basis, and we have to complete and go much deeper on the profitability increase in Portugal, according with our restructuration plan.

We will simplify and rationalize our processes, our structures, and we will maintain the focus in customers, new business and a very strict, strict control of cost and strict control of cost of deposits. So, this will be the focus for 2014. And, as I mentioned, 2014 will be a very important and a very demanding but I think positive year for the bank. Let's see. And now, I'm passing the floor to Miguel that will go in much detail in some of the issues that I raised before.

Miguel de Campos Pereira de Bragança

Thank you very much. Ladies and gentlemen, I will comment now at group level what are the main highlights of our financial performance. So, what you see in page eight is that we have been – we're in a very healthy position in terms of customer funds, with deposits growing 5.2%, and it's both in Portugal and in international operations. Our focus has also been, in this case, to try to manage well our deposit cost as a key lever to for the development of our margin.

In terms of loans, we keep the reduction in loans that has been seen in the last couple of quarters, albeit, at a slower pace. What you see here is that the mortgages, which is our bank book of mortgages with quite, I would say, comparing to today a small spread of around 116 basis points, have been reduced by around 3.6%. And we have here an interesting development is that the stock of loans to companies has decreased already at a lower rate than the one of mortgages, which is particularly interesting once the loans to companies have a shorter maturity.

The impact of this development has been a further reduction of the commercial gap, so, our commercial gap has reduced a further €5.5 billion, after reducing in the last years more or less at the rate of €7.5 billion a year. So, we keep reducing the commercial gap. And our loans-to-deposit ratio is already at 117 basis points, and our net-loans-to-customer-funds ratio, so including also retail bond, is already 108%. So, I would say big tick in terms of criteria. This has allowed us to reduce the net usage of the ECB to around €10 billion Euros while still keeping around at the €10 billion net of haircut – as a cash-in buffer of eligible assets. So basically, we have twice as much eligible assets as the usage that we are making from the ECB, which gives us an additional comfort. In terms of the – our refinancing needs, they are quite small, if you take a look at our maturities looking forward. This year we have around €3 billion, which is quite manageable taking into consideration what we had last years. And an important part of this €3 billion, around €1 billion is covered bonds, which may be repackaged without any problem. In terms of capital, I will also say a big tick here. Our core Tier 1 ratio has improved to 13.8%. This has been the consequence of many, many initiatives. One very important initiative that you have seen already in the last quarter was the sale of our Greek operation and the sale of the Piraeus share that we have received as part of the Greek deal. So, this was very important. This represents around $4 billion of reduction of risk-weighted assets.

Another important initiative that we have developed was a synthetic securitization, which represented around $2 billion of risk-weighted assets through lease with genuine risk transfer, and there was an impact of around $3 billion in terms of risk-weighted assets of our – the entry into advanced methods for the corporate portfolio in Portugal.

There are still some initiatives going on, but please keep in mind, we have managed in 12 months to reduce the risk-weighted assets by $10 billion. So, it's important. This gives us also some credibility to the initiatives that we have presented when we presented the capital increase. This was particularly challenged. And also, in this work stream we are ahead of a very aggressive schedule.

The pension fund, we have a conservative pension fund. The liabilities coverage is above 100% and the fund's profitability was around 4.4%, while the actuarial rate was 4.5%, so there are – practically there is no actuarial difference. There is an impact in terms of the reduction of the discount rates from 4.5% to 4%, which had an impact of around that – in terms of – actuarial differences of €200 million. But I would say that is already totally aligned with the ratings that our competitors in Portugal are using.

Profitability, after solving the liquidity issue and after being ahead of schedule in terms of the capital issue, the profitability becomes even more top of our management agenda. We see here also some positive development that we may comment a little bit further. But in general terms what we see is that the net

interest income is – after correcting for the CoCos, more or less aligned with last year. You will see this a little bit more in detail once we go to the different geographies. So basically, you see that the reduction in net interest income basically is the one that is related to the payment of the CoCos.
And here for the Portugal operations, basically what you see is a very positive impact in terms of the reduction of the deposit costs. So, we have been able to reduce the deposit costs significantly as we will explain. And fortunately, this is being compensated by the impact on the asset side. So, the deleverage of the credit that is happening at a faster pace and what we now would envisage is compensating this; and also some reduction in terms of the new healthy credit spreads that we are giving. So, one is compensating the other when you compare this with the previous quarter. Okay?
On top of it, the previous quarter was a particularly good quarter in terms of NPL recovery of interest cost. But I would say, all in all, the big impact here in terms of net interest income was the CoCos that explain basically the differences vis-a-vis last year and the other impacts compensate each other.
In terms of net fees and commissions, they are growing €8 million. In terms of other operating income, what you see is that basically last year, we had a big impact of the debt repurchase, that explains the reduction of the trading gains. So, these have the impact that we commented of around €300 million in terms of banking income. In terms of operating costs, once you adjusted for the restructuring costs, you see a very positive development. We have anticipated the restructuring charge for this year, ahead of what, I would say, was being planned. And we have had a normal, so to say, head count reduction that was responsible for around €26 million this year. And on top of it we have made a restructuring charge of around €100 million. If you adjust for it, the restructuring charge already presents a very positive development, as you will see.
The impairment and provisions show already some positive signs that we'll also explain later on, while of course, keeping an important number; that is one of the areas that we expected over time will evolve also positive.
In page 17, basically what you see is – what are the factors that have had contributed to our net income, that would probably not contribute in a mature phase of our income statement. So, once we pay the CoCos, once the impact of the liability management operation cease, once we have done the restructuring costs, everything that we had there in these first two lines will be compensated.
And now going to the different lines of the income statement, what you see here is that the net interest income basically is stable after you adjust for the CoCos, which is a positive development, mainly because the negative part of the net interest income that has been the deleveraged part of the asset side, once it ceases, and if we can keep the positive dynamics in terms of the interest – in terms of the deposit costs, I mean, we will start having here positive jaws, if you want, in terms of the impact of the credit vis-à-vis the impact of the spread of the deposits. The fees and commissions, you see also some stability in spite of some regulatory challenge in terms of the current account related fees that was reduced, but it was compensated by asset management fees and by other type of fees, so we see here, I would say, some stability. Here, again, the fees are also suffering from a lower loan origination than what we were expecting. So once we reverse the trend, this is

also one of the areas that we expect to have a positive income in terms of our P&L.
The net trading income goes down to a more normal level after the buyback that we had in 2012. And the operating cost, as commented, reduced by 11% in consolidated terms after adjusting for the restructuring charges, which is important. And these 11% are a weighted average of the reduction of 15% in Portugal, very important, with the 2% in international operations. Okay.
The loan impairment in line with the guidance that we were giving in the last quarter, closed at the level – close to 140 basis points, so slightly below the 140 basis points that were our guidance. As you see here, this allows us to keep our strategic plan, objective of getting to a level of around 100 basis points by 2015, so we – and with a consistent development also in this line of our income statement.
The good news here is the net new entries in Portugal. So what we see is that, in line with what we have presented in the previous quarters, the net new entries of NPLs in Portugal are going significantly down by a level of more than 50%, and you see this trend happening basically in the last quarter of the year. So you see that until September, the NPL ratio and the credit risk ratio increased somewhat. But then, between September and December, you already see a positive development also in this ratio. This has allowed us also to increase the coverage from September to December.
And of course, I mean, our keeping the collateralized nature of our loan portfolio. So we have a diversified portfolio, 50% company, 50% individual loans. And in the 50% individual loans, 90% are mortgages, with a high degree of collateralization, so we only have 12% of mortgage retail and LTV above 90% and the average LTV is 67%. So, here again, we have a high level of cost reduction. And this is basically the general view of our group financials.
I will now pass the floor to Rui, our Chief Investor Relations, to comment on the different operations.

Rui Pedro da Conceição Coimbra Fernandes

So, on page 26, the volumes for Portugal, it was already mentioned. The deposits increased 4% and the loans to customers decreased 4.7% and this, looking to company, that is probably the most relevant in terms of the potential effect on our net interest income it is already – this type of negative rate is already quite less than the quarters before and definitely comparing to previous year. But still negative and causing a negative effect on net interest income, as we will see.
In terms of the net income, decreased compared with the previous year. It seems the decrease on operating cost was not enough to compensate the 27% decrease on banking income where the main reason starts to be net interest income, net interest income. It was already mentioned that the decrease of €150 million year-on-year had a major effect, the cost of CoCos that caused the difference of €134 million, but there's a second big negative effect, this €109 million that is coming from [indiscernible] (27:27) Although we see a decrease on the portfolio that is less than these average volumes, the portfolio of credit decreased in Portugal of €4.5 billion. And this if you assume which is our more or less average interest rate of 3%, easily you understand this more than €100 million as a volume effect.

This was more than compensated by all the efforts on decreasing the rate of the time deposits, obviously. And it was on the moment that the Euribor stopped to decrease that we start to make really money here on the net interest income with the decrease of the time deposits rates, because before that we were decreasing the rates but at the same time the Euribor was decreasing, so, at the end, in terms of spreads, the gain was not big. It will be more definitely for the year 2014 than this €26 million gains here. But, as it was mentioned already, the performance of NPLs during the full year 2013 when compared to 2012 made a positive effect on the net interest income of around €38 million, and then all the other effects contribute positively as well.

When we go on quarter-on-quarter, the decrease of €10 million is mainly explained by the effect of past due – the effect on past due loans, on the net interest income, that was higher than the previous quarter. And this explains more or less the decrease. Since the effect, the positive effect, coming from the customer funds margin of around €10 billion was more or less compensated by credit effects both in volumes and as well on the pricing. This obviously going forward especially the customer funds margin, we expect to continue on this type of trend at least on the first and second quarter, and some of these negative effects we do not expect to continue.

Now, in terms of rates for the time deposits, we see the evolution since the last two years. Now, we are for the full portfolio at 2.4% and 2% in terms of new production, which means that continuing the new production at around 2% there is still space for the portfolio to converge down. And in terms of spread, at least this is what we expect if we have any dynamics on the Euribor, then we will see even more gains in terms of the spreads here. Although as we announced one year ago on our strategic plan for the target for the time deposit spread, that 170 basis points for 2015, we are really on track to achieve this target.

In terms of credit portfolio rate, we saw during the year a decrease in companies and an increase for mortgage but especially for companies still at higher rates. In terms of commissions, it was mentioned already this negative effect here, evolution for Portugal although quarter-on-quarter is already positive. The main difference that is making this evolution is definitely the numbers for loans and guarantees, that when we see the full year, the decrease was 12%. But now, it is already quarter-on-quarter with a positive 12% as well that makes the total to be a positive number.

In terms of operating costs and still in Portugal, we decreased 15% operating costs, and this came both from staff costs and admin costs. Staff costs related – after the almost 1,000 decrease on the number of employees last year, this year was around 400.

For this, we have a cost of around €26 million and another €100 million we booked as a provision to achieve the target of 7,500. So, we booked up-front all the costs related to the way to achieve these numbers.

In terms of, when we compare with our peers, we are already in a place that has nothing to do with the past, but still, we have a lot to do here both, as I mentioned, on the staff costs, but as well on the admin costs where we decreased 12% during the year, and with specific two or three important projects that helped very much to achieve these numbers. One of them, renegotiation of large outsourcing contract that helped on the reduction on the communications and IT costs here of 22%, but as well the global organization of central services and the decrease and the closing of branches made as well, for example, made possible the rents to reduce, the rent cost to reduce 5%.

Moving to credit quality now, we had a decrease here on the NPL ratios and credit risk ratios from September to December. This was done and it is explained here on this table for the NPL evolution that from – during the year, we managed to increase €149 million coming from the net new entries of 634 and then if we deduct the effect of write-off and sales. But if we see quarter-on-quarter even the net new entries was already negative, which means that we recovered more than we allowed to enter in NPL. So it's a performance that I would say that is a little bit ahead of the schedule, as well, these dynamics on NPLs. Cost of risk, still very high, at 157 basis points, although much less than previous year, the two things at the same time made us to increase the coverage of both NPL and credit risk ratio from September to December.

Closing Portugal, a note on foreclosed assets. During the year, as we see, we managed to sell more than the new entries. Actually, we sold 29% more properties than the previous year, with the value of 46% more. So, it means that each item was sold by a higher price. And these dynamics made the stock of the foreclosed assets to decrease. As you probably recall from the third quarter, we booked a provision of, rather generic at that time, of €80 million that, for the end of the year, there was a need to allocate it. And so, out of the €80 million, €40 million was allocated to foreclosed assets and €40 was allocated to normal provisions upgrade. So it was the same time the decrease of the assets, but at the same time, the increase of provisions of this €40 million that made the coverage to be at a level much higher than last year, and that's a comfortable level of 26.5% as coverage.

Moving to the international side now, the three subsidiaries that are core for us made already a net income, €253 million altogether, which – and after taking minorities, there was a positive contribution of €178 million for the P&L of the group. Starting by Poland: important growth in both customer funds and loans to customers. But more than this, there is an item that is relevant here that is the composition of the increase of the loans in Poland. Strategically, there were two important issues here in terms of increasing, in terms of the mix of both customer funds and loans to customers. In terms of customer funds, the increase of share of demand accounts that – compare to time deposits. And this share moved from last year from 34% to 39%, which, as you can imagine, is responsible for part of the increase of net interest income that we saw during the year.

But on the other side – on the loan side as well, there was this strategic initiative, as well, of increasing the share of the non-mortgage portfolio, and this happened as well to – from 34% to 37%. So the two together improved very much the mix of the balance sheet that gave an important contribution for the net interest income. Overall, for the net income, an increase of 13.5% coming from a 2.8% increase on banking income and 2.8% decrease on operating costs.

On the net interest income, towards the – it was mentioned already, obviously, that the volume effect helped very much here since net interest margin was rather

stable at around 2.3%, although suffering from the decrease of the markets' rate and, on the positive side, the mixed effect that I already mentioned.
In terms of fees and commission, an increase of almost 8% mainly from mutual funds and *bancassurance* commissions and operating cost, the decrease of 2.8%. On staff, 2% which is going with the dynamics of the decrease of the number of employees that decreased 2% as well. And that means, very much related as well with the decrease of the number of branches. In terms of credit quality in Poland, rather stable, very low stable NPL number, stable cost of risk and very much as well a very high stable coverage ratio in terms for the NPLs.
Moving to Mozambique, important increase again in volumes, 19% and 24% for customer funds and loans, and improvement on the net income of 9% coming from a 7% increase both from banking income and operating costs. Net interest income, an increase, that obviously was very much related with volume since net interest margin, although very high, decreased to 7.1% but at a very high level still. And this was mainly caused by the effect important of the interest rate on bonds that decreased from 12% to 6%.
Fees and commissions, an increase of 22% and the increase on cost of around 7% related of course with a number of branches and a number of employees and salary increases as well here in Mozambique. Credit quality, decreasing on the NPL ratios, very high coverage even with the decrease of the cost of risk.
Moving to Angola. Strong, strong volume growth both on deposits and loans. Almost 14% increase in net income coming from the increase on banking income and less on operating costs. This strong volume effect obviously affects net interest income as net interest margin is relatively stable around 6%, even with the interest on bonds as well going down, fees and commissions up on the operating costs, 3.5% up, which is less than the increases on the number of employees and branches. For credit quality, decrease on NPLs, decrease on cost of risk and even though an increase on the coverage ratio.
At the end, we show, as usual, the *tableau de bord* where we compare ourselves with the targets that we have in our strategic plan. As Miguel Bragança mentioned already, in terms of capital and liquidity, we are on track in our plans. Cost-to-income, obviously still space to go but mainly on the income side, since operating costs, we are ahead of the plan. Cost of risk, converging to the 100 basis points for 2015, so we are on track, and obviously with the return-on-equity as a result of this.

Q&A

Operator

Thank you. [Operator Instructions] We will take now our first question from Benjie Creelan-Sandford from Macquarie.
Please go ahead.
<Q - Benjie Creelan-Sandford>: Yes. Hi. Good afternoon, everyone. Yeah, I just had a quick question around the capital position. I mean, first of all, I was just wondering whether you could give any guidance on the current fully loaded position on the Basel III basis? And secondly, just on the risk-weighted assets, obviously we've seen a very strong decline in the quarter, can you just give a bit more detail on the exact drivers of that quarter-on-quarter? And has anything gone beyond the targets you already laid out in your business plan, i.e., is €40

billion still the ultimate target for 2017 or do you think you could go lower than that?

<A - Miguel de Campos Pereira de Bragança>: Okay. So, Benjie – okay, in terms of the fully loaded target, so there are still some issues to clarify in terms of the ratios of CRD IV and Basel III and we will start disclosing the CRD IV targets, CRR targets and fully loaded targets starting next quarter, in terms of the impact of capital and the reduction of the risk-weighted assets in this quarter. So basically, the impact from September to December has been, as I commented, the reduction of risk-weighted assets due to the advanced IRB method which is basically responsible for around €3 billion of reduction. And as I commented, in the context of the Greek deal, we had acquired a position of around €400 million of Piraeus shares. And by selling these shares, it had a special weight of around 290%, we had an additional relief of risk-weighted assets of around €1.2 million to €1.3 million, okay?

In terms of the final target, we still keep the €40 billion as the final target. But this has implicit that we will grow our trade portfolio. So we want to – next year, the guidance that we are giving is some stability of the trade portfolio but with an improvement in the composition where we keep the reduction that we are having, the yield reduction in terms of the mortgage portfolio and compensate this with growth in terms of the company's portfolio which will have – one will compensate the other, but this has a positive impact in terms of the profitability of the bank. But of course, looking at 2015, 2016 and 2017, we hope that over time and once the economy starts to recover, the speed at which our credit portfolio will increase, will also increase, okay? So we keep the €40 billion but with a higher profitability, okay?

<Q - Benjie Creelan-Sandford>: Okay, great. Thank you very much.

Operator

Thank you. We will take now our next question from Carlos Peixoto from BPI. Please go ahead.

<Q - Carlos Peixoto>: Hello. Good afternoon. Three questions. I was wondering if you could give us a bit on your expectations on the evolution of NII and also on NPLs net new entries which were the – I would say one of the main positives from the set of results, whether you see this pickup in recoveries or the fact that the recoveries are outpacing NPLs net new entries as something that could be sustainable throughout 2014?

Also, regarding capital and I was wondering if you have any potential update on the status regarding the DTAs reform in Portugal and whether you see the room for a possible anticipation of the CoCos payment during this year. So I believe that the initial estimate was to be something around €400 million towards year-end. I was wondering whether this could be anticipated in the year. Thank you.

<A - Miguel de Campos Pereira de Bragança>: Okay. Thank you. Carlos, so, in terms of the different addition points that you mentioned, starting here probably with the CoCos repayment, our original target was to repay €400 million until year-end. Of course, this is dependent on federal authorizations by the Bank of Portugal, by the EBA and so on. But presently, our target is to make sure – to apply for the €400 million in the first half of the year, okay? Of course, whether we will be allowed or not, it does not only depend on ourselves but we think there are good reasons for us to be allowed to pre-pay €400 million until year-half. In terms of the CoCo – of the DTAs, we think there are conversations going on mainly after Italy and Spain have approved their rulings. There is some space to make sure that Portuguese banks stay on a level playing field with similar banks in Europe. Please take into consideration that other banks, I mean, have to – I mean, we provide for credit losses that are in excess of what is deductible at a certain point in time. So it makes sense that this excess is not necessarily deducted.

So it makes sense that the timing differences are not deducted from capital because we have this asymmetry in terms of the deduction that we are able to do for tax purposes and the amount that we charge to our P&L segment exactly in line with what happens in Italy and with what happens in Spain, and contrarily, to what happens in some other jurisdictions where the amount that you charge to your P&L is exactly the same amount that you are then able to deduct from your tax filings.

So we think it makes sense, we think this is very important also for the system to keep the credit flow into the economy and we think that the – at least the Bank of Portugal is sensitive to this reasoning and of course, as always, this also depends on the political decision-making. But we think there are good reasons to make sure that we are not put on an uneven level playing field, okay, in terms of DTAs. We would also expect for something to happen in this regard to happen in the first half of the year, okay? So this is our expectation. But this is less dependent on ourselves than on the Portuguese political institutions, of course. In terms of the NII, as we have commented in page – let me just check here – in page 29, we have here a specific evolution of our deposit spreads. We are delivering on this evolution of the deposit spread and the NII that we are expecting in Portugal is more or less the following: so we expect a minor improvement in terms of the credit rates because we will have – we'll be having here some positive so that the total amount of credit will be reasonably constant. But there will be a change in the composition which will have a positive – slightly positive in the first year - impact in terms of the return on assets and in terms of the return on our credit. On the other hand, we expect these trends in the deposit rates to continue and this to be a major profitability lever. So the guidance that we would like to give is this one: a minor improvement in terms of the credit rate and a continuation in terms of the improvement of the deposit rate, in line with the one that we are presenting in page 29, okay? This is in terms of NII.

In terms of the NPLs, I don't think that necessarily it is sustainable to have quarter after quarter more recoveries than loans that. So what we think at least over the next quarters will happen is that the stock – the net NPLs or the net new entries in NPLs will continue to reduce albeit at a smaller pace, but what we do think is that these net NPLs are a leading indicator of the impairment charges, and we continue to maintain our target for impairment charges in consolidated terms that we commented here in page 22 of getting to level of around 100 basis points by 2015.

So, the leading indicators are there, the leading indicators will continue to be positive, and we expect, in principle, of course, it's difficult to predict everything regarding the future, but it is our base case is to go to a level of – to go in a sustainable way to a level of around 100 basis points by 2015 as we comment in page 22. Okay. I believe I have answered your four questions.

Operator
Thank you. [Operator Instructions] We will take now our next question from Ignacio Ulargui from BBVA. Please go ahead.
<Q - Ignacio Ulargui>: Hi, gentlemen. Good afternoon. I have two questions. I mean, just to come back a bit on the deposit costs. If I just look to your presentation, the target of 170 basis points negative spread is pretty much in line with the 2% from book that you are having these days on term deposits. I mean, do you think there's a scope to reduce this below the current levels of new production that you have or you think that the 2% is the bottom?
Secondly, regarding the rationalization of course in Portugal, I mean, the €700 million that you target for 2015 look to me, as you said, as you called, may be already achieved, I mean, just to see whether just in those scope, I mean, to come down that €700 million to levels like that, like €650 million, something like that. And there's just other – a small question at the end regarding the deconsolidation of Romanian operations. I mean, what could be the potential reduction in risk-weighted assets if you complete the sale of this operation? Thanks.
<A - Miguel de Campos Pereira de Bragança>: Okay. So, first the deposit costs, well, as there is room to go a little bit further than the guidance that we are giving now... I would say we can always do better and we will try to do our best to do better than the guidance that we are giving now. But the guidance that we are giving now is the guidance that we're giving now. But of course, our internal targets are to do better than this – it is normal, okay? And the same goes also for the cost base. So, what we said at the time of the capital increase was that we wanted to reach deposit rates of around €700 million in Portugal. What we say today is that we want to go significantly below the €700 million. So, the €700 million, we will go below the €700 million and the €700 million is a target that is for the restructuring effort that we are proposing, so to say, quite conservative, a quite conservative target. Okay? In terms of the deconsolidation of Romania, Romania is small, as you know. The asset is, I would say, a clean bank, the country is an interesting country from a macro perspective right now. It is also an interesting case for a consolidated because there are many small banks in Romania, but it is not, how can I say, it is not a very interesting asset because it is a small asset, it has a small market share. So it is – but it is a small asset. So what we would expect is a slight positive impact, if anything, from the sale of the Romanian asset in terms of our asset base but not much more than that. Okay?
<Q - Ignacio Ulargui>: Thank you very much.

Operator
Thank you. We will take our next question from Juan Carlos Calvo from Espírito Santo Bank. Please go ahead.
<Q - Juan Carlos Calvo>: Good afternoon. Actually, my questions have been answered already. So thank you.
Operator
Thank you. We will take our next question from Antonio Ramirez, KBW. Please go ahead.
<Q - Antonio Ramirez>: Hello, good afternoon. One question from me on the – if you can clarify - on the fourth quarter cost, percent of cost, do you include –

my understanding is you include a €126 million of restructuring charge. So if we adjust for that, the €252 million of the quarter, the rest of the personnel expense would be around the €126 million, and that compares to €171 million in the previous quarter. So it looks like a pretty sizeable reduction in only one quarter. So I was wondering, was there any positive impact in personnel expenses that you booked during the fourth quarter? And also, if you can elaborate on the agreement you achieved with the unions for the salary cut in Portugal, which on average I think you have mentioned 6%, is that all coming in 2014 or part of that has already been included in the fourth quarter? So I'm trying to figure out what's the level of personnel expenses that we should consider starting base in the fourth quarter if we remove the €126 charge that you have explained?
Also related to that question and clarification on this 6% salary cut, what's the timing for the personnel leaving the bank? You are targeting around 1,100 people to leave the bank over the next three years, but the fact that you have taken the charge up-front, I would suggest – it would imply to me that this will happen much, much quicker. So if you can give us some indication on how this process will evolve, that would be great.
And then maybe a final question on capping out. You mentioned before your plan to repay €400 million CoCos, and you will apply for that in the first half. Do you expect that... do you think is realistic for the regulator to approve that just a few weeks or few months ahead of the ECB asset quality review of stress test, or do you think this – being more realistic - is probably more second half of the year event? So that's all for me. Thank you.
<A - Miguel de Campos Pereira de Bragança>: Okay. Starting probably with the last question, first, we are all in a new environment. So everything is new. This AQR is new, the European Central Bank role is a new role. So in this scenario it's particularly difficult to make very assertive affirmation. But when I say that we will apply in the first half is because we think that we have – I mean, rights to apply because we think that it is reasonable for us to have this waiver. So we think it's reasonable, but of course, you are right that nobody can ensure in such a volatile environment, what will be the reasoning of the different stakeholders that will look at it. But we think we are right and we think it's reasonable. Okay. So this is the first question. In terms of the €126 million, and thank you for asking because this probably is not totally clear, so we should separate this into two parts, okay. We have the €26 million and the €100 million, okay? The €26 million, I would say, are restructuring costs that have been done this year, so to say, in a calm way, as almost ordinary course of business without being recurrent but that have been done, €11 million up to the third quarter as we have commented in page 15 of our previous presentation and €15 million in the last quarter, okay? So the €26 million are already incurred costs, okay? And the €100 million is a provisioning charge for the costs that we will incur next year. So this explains a little bit that you cannot correct the Q4 net income by €126 million. If anything, you can only correct by €100 million and €15 million, so that's probably what could be done. In terms of timing, so we expect to have the reduction to around 7,500 people done during this year. It will probably be done in the second half of the year, because what is the timing? We have signed an MOU with the unions, so it's signed but it's an MOU. Now, we have to have a

formal contract with the unions that is a general company's contract with the Unions. And then in order to apply the salary reduction to non-unionized workers, so to say, there has to be a... a special approval from the government in order to apply to non-unionized workers, okay? So these are the steps. And then we have to start the process. So I would expect the process to start by the end of the first half of the year, and this process starts – it takes some time, negotiations and so on. So I would say the process to end probably by Q3. So we will have probably the full benefits of this process in 2015. But don't expect, so to say, the full – but the implementation will occur during 2014, okay? This is the timing.
<**Q - Antonio Ramirez**>: And then in terms of the 6% average salary adjustment that you have mentioned, is there any impact already in the fourth quarter and what would be the impact or what would be the timing for that in 2014?
<**A - Miguel de Campos Pereira de Bragança**>: Yes, it will be, in principle, Q4, maybe Q3 and Q4 depending on the approval process of the government. Okay?
<**Q - Antonio Ramirez**>: Okay. So you will not benefit the full of 2014? So, basically half year?
<**A - Miguel de Campos Pereira de Bragança**>: Yes, depending on the approval process and the approval time. Of course, we cannot guarantee because it does not depend only on ourselves but these are the targets that we are managing right now.
<**Q - Antonio Ramirez**>: Okay. Thank you very much.
Operator
Thank you. We will take now our next question from Mario Ropero from Fidentiis.
<**Q - Mario Ropero Garcia**>: Hello, good afternoon. I have a couple of further questions. The first one, I know that you are already below the 120% loan-to-deposit ratio. But I would understand that it would also be healthy to be below this ratio in each of the subsidiaries. So given that in Portugal you are about this, I just wonder whether you think that this should go further down because you were also saying before that you are now expecting, well, further loan growth on loan to companies and that this could offset the run-off of the mortgage portfolio. And then my other question is regarding fee income. Well, you have a negative impact of €60 million due to the state guarantee costs and I was wondering how you expect this to evolve in 2014. I mean, I guess that this is going to do down. I just want to hear your comments. Thank you.
<**A - Miguel de Campos Pereira de Bragança**>: I'm sorry. There was some problem in the sound connection, so I have not understood exactly everything that you asked, but I hope to answer your question. If I miss something, please repeat it.
I understand that your first question was related to our loan-to-deposit and whether we want to go much further than that or not. I mean, we are close to a level that we think is sustainable, so between 110% is something that is a level that we think makes sense for a bank of our size. What we will do progressively is to focus more on the margin. It will depend on the trade-off between the margin and the cost of funding. So, what we'll – we will not be focusing very much on the minimization of this ratio. We are comfortable in this regard, so that...
<**Q - Mario Ropero Garcia**>: Sorry, Nuno – sorry, I was also referring to the loan-to-deposit ratio in Portugal.

<**A - Miguel de Campos Pereira de Bragança**>: But also in Portugal, mainly, if you consider loan to total customer funds ratio, we are okay. So, the ratio that we have right now in terms of loan to total customer funds ratio that is much more relevant than loan-to-deposit because the only relevance of the loan-to-deposit ratio is that because it has been stated as a reference for the Troika. But as you know, to have a bond, a retail bond or a deposit, I mean, it's exactly the same. So, for us, from the liquidity management standpoint, the loans to total retail bonds and deposits is already below 120%.

So, we are close even in Portugal – even only in Portugal. So, we are close to our targets. Right now, the priority is much more the reduction of the deposit cost and effectively, that is one of the reasons why we are reducing the deposit cost, okay? In terms of the State guarantee cost, as we have done in the last year, we will, every month and every quarter, evaluate very carefully whether the opportunity cost of having the state guarantees on the bonds make sense or don't make sense. And, if appropriate, we may ask to cancel these guarantees saving there the cost of the guarantee. Due to our comfortable liquidity position, this is something that we will evaluate very carefully. And as the situation of the country improves and improves, it is probably that we – if the situation improves - that we ask for a further cancellation of these guarantees, okay? Then, the issue around these guarantees, as you know, is that once you cancel it, there are no new guarantees. So, that's why we have not cancelled them yet because they are, once and for all, irrevocable, okay?

<**Q - Mario Ropero Garcia**>: Yeah. Okay. Thank you.

Operator

Thank you. We will take now our next question from Roberto Casoni, Otus Capital. Please go ahead.

<**Q - Roberto C. Casoni**>: Yeah. Hi. Good afternoon, everybody. I have a question regarding your expectations on non-performing loans provisions for 2014 and going forward. If I well understood you expect net new entries to be a bit better than what we've seen in 2013, not negative as much as Q4 but, let's say, a bit lower; so, say, €500 million compared to €625 million. Now, if I well understood, your current coverage is well accepted by Bank of Portugal and the authorities, otherwise that would have forced you to provision more. Now, if you – if the new entries will be €500 million in 2014, then you only need to provision €250 million, 50%, which is not exactly 1% of your loans. Can you please elaborate better on that, please?

<**A - Miguel de Campos Pereira de Bragança**>: Let me just here comment on your question. Right now, what we have is coverage that is in excess of 100%, if you have both the collateral value and the provision.

<**Q - Roberto C. Casoni**>: Yeah.

<**A - Miguel de Campos Pereira de Bragança**>: So, provisions plus collateral value is – I mean, make up to the – is perfectly consistent with our 100% coverage.

<**Q - Roberto C. Casoni**>: Yeah.

<**A - Miguel de Campos Pereira de Bragança**>: I would say what we have here is some degree of prudence, so to say, that in terms of this collateral value evolution because there is some – also some adverse selection in terms of the collateral value of NPLs. So, as the loans turn a little bit more sour, so the recovery of the amount

that we expect to recover may... of course, become more challenging. So – and that's why the guidance that we are giving is to go over time to a level of 100 basis points.
<Q - Roberto C. Casoni>: But this is in contradiction with: A, the number of foreclosed assets you have been selling. I am assuming that most of your collaterals are real estate, basically; and second, it goes against, let's say, my assumption that if your collaterals were overvalued, Bank of Portugal would have already forced you to reduce the value of those collaterals. So when I look at the combination of – I can't remember the page, but you understand what I mean.
<A - Miguel de Campos Pereira de Bragança>: Okay. I understand, Roberto.
<Q - Roberto C. Casoni>: Yeah.
<A - Miguel de Campos Pereira de Bragança>: I understand your question. We are well provided for. Our collateral values are realistic, and there have been several appraisals of the collateral values that we have, but there is a normal typical adverse selection in collaterals of non-performing loans, so.
<Q - Roberto C. Casoni>: Yeah.
<A - Miguel de Campos Pereira de Bragança>: And the fact that the value is correct today does not mean necessarily that it will not evolve over time. So, it evolves over time. So, we think that our provisions are realistic for the new evolution of NPLs that we may have next year. And our numbers fit with each other. If you want them, you can contact here our Investor Relations and going in deeper details in terms of the numbers, okay?
<Q - Roberto C. Casoni>: I understand. Thank you.
<A>: Okay.
Operator
Thank you. We will take now our next question from Jaime Hernández from Nomura. Please go ahead.
<Q - Jaime Hernández>: Hi. Good afternoon. Thank you for taking my questions and congratulations for both the results and the market reaction. I've got three questions. The first one is related to the other provisions that you already clarified, that you expected loan charges or the loan cost of risk going forward. I was wondering if you can clarify what you're expecting on the other provisions. I assume mainly the ones related to the foreclosed assets. And also if you can – on the foreclosed assets, we saw that you increased significantly the coverage during the last quarters, reaching 27%. Is that the level that you will keep to cover new entries or it will continue to grow in the coming quarters? Both questions are related on the provisions guidance.
The second one is related to the IRB models and the additional risk-weighted asset optimizations that you have mentioned before. If you can please confirm us the timing or the expected timing; I understand that is not easy, but the expected timing of the additional risk-weighted asset optimization. And if there are further IRB models or advanced models at the domestic business that could be approved on the top of the ones related to Poland. And the third one is if the confirmation – well, most of us we're expecting the confirmation of a change in the DTA rules in Portugal as we saw in other countries, if that could change the initial schedule or the initial timing on the repayment of CoCos?

And also, if you can provide us the breakdown of the DTAs by type of – or at least to give us how many – how much of the DTAs are coming from temporary differences? Thank you.

<A - Miguel de Campos Pereira de Bragança>: Okay. First, the issue around other provision. So, it is true that this year we have had a large number of other provision. One of the important parts of it had to do with Piraeus. Other has to do with the mark-down or with the provision in restructuring funds and in their mark-to-market. What we expect is also this number to go significantly down for next year because, as I commented, part of the numbers that we have this year were extraordinary. So, we will probably look at it on a more recurrent basis. We'll take a look at it probably in the last couple of years to see more – what would be here, our recurrent basis. In terms of the timing of the further reduction of risk-weighted assets, there are... is always an effort here in terms of the reduction of risk-weighted assets, but the advanced IRB has been approved right now. So, the issue right now is not to make a new approval of the advanced IRB. It's to calibrate the numbers so that the conservative values that we have in a first approval, because normally a first approval has always some type of certainty equivalent, and there is an additional degree of conservatism to compensate for, I would say, for the first approach and the first approval. So as time goes by, the regulator gets more data, gets more history, gets more confidence in the data, and with more data, with more history, and with, hopefully, also some improvement in the situation of the country, there will be a gradual improvement in terms of risk-weighted assets.

And exactly how this will occur, I would say that it will occur gradually, but this is not – I would not expect some quantum leap or some discreet gain here. I would expect – now it's more hard work. Now, it's more a marathon than a sprint. So, what we have to do is to keep improving our models, keep getting more data, so as to give more comfort to the regulators and as the regulator gets more data, more comfort, more history; some degrees of conservatism that these models always have may get a little bit more realistic and as this goes by the risk-weighted assets may reduce.

So, I would say it will be gradual. So, in terms of the remaining improvement, it will be gradual between now and 2016, so that is what I would say. Also as the model, the only other big model that could have an impact that we are now exploring is the operational risk model. This will be also by the – for the end of 2015. It is nothing immediate right now... In terms of the DTAs and CoCo's and so on. So, I would like to – so, when we presented our CoCo repayment schedule, there was not foreseen, so to say, a DTA – a change in the DTA rule. So, what we have presented, because we thought it was fair, was a specific schedule that you know what it is. So, it is €400 million this year and €2.3 billion up to 2016 in order to keep Poland, and this was independent of the relaxation of the DTA rule that Italy and Spain have done. So, we are keeping these targets. The issue is that we don't know exactly... in the meantime, also, as you all know, the regulatory framework has also changed and what do I think that the DTA rules allow us is first a better access to the market, because people are looking at fully loaded ratios, people are looking at rating agencies, they're looking at fully loaded ratios.

And the main impact of the DTA rule is not on the phasing, because the phasing for the DTA is up to 2024, but it's on the fully loaded. And the fact that this could improve significantly our fully loaded, significantly improves our access to the market, making us more – making it easier for us to allocate funds into the economy and also maximizing, probably, the changes that the regulators also approve the CoCo repayment, but we are not changing the CoCo repayment schedule. Okay?

In terms of the temporary differences, the total temporary difference that we have is €1.9 billion. Of this €1.9 billion, around €1.6 billion are related to credit and pensions, correct? Okay. So, that is – so if we were to apply the Spanish regime, the DTAs that would be eligible for temporary differences and pensions and credit are around €1.6. Okay?

Of course, in Spain, the regime is even more favourable because you also get the relief for non-temporary differences incurred after 2011, so...

<**Q - Jaime Hernández**>: Okay.

<**A**>: Okay. Thank you.

Operator

Thank you. [Operator Instructions] We take now our next question from Carlos Peixoto. Please go ahead.

<**Q - Carlos Peixoto**>: Hi, again. Just another question. I believe, I had asked this in previous occasions, but in any case, I was wondering whether your insurance business would be something that you could be considering selling, particularly now that the appetite for Portuguese equities seems to – and for Portuguese businesses - seems to have picked up, whether the sale of the insurance business could also be a measure that the bank could consider to optimize the capital position and basically minimize the impacts that could have under Basel III framework. Thank you.

<**A - Miguel de Campos Pereira de Bragança**>: Carlos, as you know, probably, we already have a majority partner in our insurance business, Carlos Peixoto, that is Ageas. So, it is... effectively the control has been sold. So, we are a minority shareholder and the big impact that Ageas sees in this business is to have here some alignment of interest. So, at least, in what could be considered a material deal, so this has been done. So, it has been sold. And of course, any placement in the stock market also will be much more dependent on the majority shareholder than on ourselves. So, I would not expect any game changers there [indiscernible].

<**Q - Carlos Peixoto**>: So, the possibility of selling the minority stake is not something that you could be contemplating for the time being?

<**A - Miguel de Campos Pereira de Bragança**>: It is not something that depends on us, I would say. I will put it this way. So, it is something that will depend much more on Ageas than on us, and our partners value the fact that we are a minority shareholder in order to have an alignment of interest with them, okay?

<**Q - Carlos Peixoto**>: Okay. Thank you.

<**A - Miguel de Campos Pereira de Bragança**>: Our partners value us for being their minority shareholder, okay.

<**Q - Carlos Peixoto**>: Okay. Thank you.

Operator

Thank you. We will take our next question from Jaime Hernández from Nomura. Please go ahead.

<Q - Jaime Hernández>: Hi. Thank you. Here I am again. It was already in my previous question on foreclosed assets coverage, if you keep those – the current level of coverage, it will continue to go forward and also – to increase further. And also, if you can give us some details on the average discounts of the almost €300 million that you sold in order to see how – compares with the coverage level? Thank you.

<A - Miguel de Campos Pereira de Bragança>: Yes. I'm sorry, you have asked this before. So, the type of – as you've seen, we have increased our – we have increased the coverage of our foreclosed assets. We think this coverage is correct, around – between 25%, 28%, we think, it's a normal coverage for the foreclosed assets, at least, we – statistically, for the small part of standard live loans. Of course, if you receive here and there a larger real estate promotion and so on, it can be seen on a case-by-case basis, and if it's large it may impact then the degree of coverage. We are selling this more or less with the same type of discount that is implicit in the coverage. So, we are selling. And that's effectively how we seek also the coverage ratio. Okay?

<Q - Jaime Hernández>: Okay, thank you.

Operator

Thank you. As there are no further questions, I would like to turn the call back to Miguel Bragança for any additional or closing remarks. Please go ahead.

Miguel de Campos Pereira de Bragança

Okay. Thank you very much. So, what I wanted to comment is that we have a very challenging 2013. We had presented the plan and basically, we're executing this plan. The main focus of the plan was the de-risking of the bank with a sharp improvement in the liquidity position and in the capital position. Going forward, what we will have is a progressive focus on – more focus on profitability. We had a very sharp improvement in terms of the P&L of the bank from 2012 to 2013. We will now have also another important challenge from 2013 to 2014, a contingent on the improvement of the country that is the base-case scenario that we have. We are committing on delivering the target that we are presenting to you, okay, and that's what I wanted to comment. Thank you.

Operator

Thank you. That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.