Q3 2017 Earnings Call

Company Participants

- Alexandre da Silva Glüher, Executive Vice President, Chief Risk Officer & Investor Relations Officer
- Carlos Wagner Firetti, Market Relations Department Director

Other Participants

- Carlos G Macedo, Analyst
- Jorge Kuri, Analyst
- Marcelo Telles, Analyst
- Mario Pierry, Analyst
- Philip J. Finch, Analyst

MANAGEMENT DISCUSSION SECTION

Operator

Good morning ladies and gentlemen, and thank you for waiting. We would like to welcome everyone to Banco Bradesco's Third Quarter 2017 Earnings Results Conference Call. This call is being broadcasted simultaneously through the Internet in the website of banco.bradesco/ir. In that address, you can also find the presentation available for download.

We inform that all participants will only be able to listen to the conference call during the company's presentation. After the presentation, there will be a question-and-answer session when further instructions will be given.

Before proceeding, let me mention that forward-looking statements are based on the beliefs and assumptions of Banco Bradesco's management, and on information currently available to the company. They involve risks, uncertainties, and assumptions because they relate to future events and, therefore, depend on circumstances that may or may not occur in the future.

Investors should understand that general economic conditions, industry conditions, and other operating factors could also affect the future results of Banco Bradesco and could cause results to differ materially from those expressed in such forward-looking statements.

Now, I'll turn the conference over to Mr. Carlos Firetti, Market Relations Director.

Carlos Wagner Firetti {BIO 2489005 <GO>}

Hi. Good morning, everybody. Welcome to our conference call. We have today with us here in São Paulo, Alexandre Glüher, Executive Vice President and Investor Relations Officer for Bradesco; Octavio de Lazari, Executive Vice President and CEO of Bradesco Seguros; Luiz Carlos Angelotti, Executive Director.

To start our conference call, I'll turn to Alexandre Glüher.

Alexandre da Silva Glüher

Thank you, Firetti. Good morning and for some of you, a good afternoon. Thanks for joining our third quarter earnings release conference call. I'll start with the main highlights in slide number 2.

This quarter, net earnings reached BRL 4.8 billion, an increase of 2.3% quarter-on-quarter and 7.8% year-on-year, representing a return on equity of 18.1%. The results shall be consistent in consolidating our positive trend that should be maintained in 2018 as economy continues to improve.

We highlight another reduction in our delinquency ratio, which maintained the improvement trend observed in the previous two quarters. The individuals and SME (00:03:04) loans ratios improved 41 basis point causing a drop in total NPL by 17 basis points in the quarter, despite some pressure from the Corporate segment.

The NPL (00:3:21) drop in the cost of (00:03:23). We understand that this trend would continue which may allow (00:03:27) historical levels towards the end of 2018. Total cost performance is among the main highlights, is stable this quarter and reducing 3.9% when compared to last year. This is a consequence of our tight control and creates the base for a model good performance during (03:49) 2018 as we captured the full benefits of the adjustments we've implemented.

As anticipated, we continue to optimize the distribution network, reducing this quarter to 223 branches. These adjustments will continue as we adapt the distribution network with the evolution our customers' needs. An improvement even in our adjustment process was the conclusion this quarter of this Special Voluntary Severance Program. We already disclosed that 7.4 thousand people decided to join the program and leave the company, which we approved and mostly and through the end of the year. The non-recurring cost of this program is BRL 2.3 billion and we will have an annual recurring reduction in personnel cost of about BRL 1.5 billion.

Loans volumes growth remains a challenge. In the individuals portfolio, we observe more consistent origination in the portfolio at an (00:04:56) extension of 0.7% year-on-year.

In the Company segment, we will still seek the long book stability. We see conditions for a better performance in the coming quarters. Our capital continues to expand organically presenting an increase of 9 basis points in the third quarter with Tier 1 reaching 15.4%, (00:05:31) very comfortable position for the future growth. We will continue to optimize our operation, focusing on the origination of loans of good quality, improvement of the portfolio (00:05:38) which should allow us to capture revenue synergy.

We understand that our result should maintain in its consistent evolution. Thank you for your attention. And now Firetti will present the rest of the numbers.

Carlos Wagner Firetti {BIO 2489005 <GO>}

Thank you, Alexandre. Now, we go for details of our results starting in slide number 3. We have the adjustments to our accounting net income. (00:06:12) adjustments are the goodwill amortization and the impact of the one-off provisions for the Voluntary Severance Program of about BRL 1.3 billion.

Going to slide 4, we have the details of the program, 7,400 people joined the program, as Alexandre mentioned, and BRL 2.3 billion here is total cost, and estimated annual benefit in terms of reductions of personnel expenses of BRL 1.5 billion.

In slide number 5, we have our income statement. I will go into details on most of the (00:07:01) in the following slide, only highlighting the ROE of 18.1%. (00:07:08) this quarter return on assets of 1.5%. Our shareholders' assets grew 11.9% year-on-year while assets grew 3.3%.

In slide 6, we show the evolution of our net earnings. In the quarter, it expanded 2.3%, and year-on-year, 7.8%. In nine months, we present an increase in net earnings of 11.2%.

In slide number 7, we have our net interest income. Basically, total net interest income dropped to BRL 14.6 billion. One of the main fact leading to this reduction was the impairment of assets that we include in the net interest income. Basically, this impairment refers to corporate bonds, and it is the recognition of a definitive loss in the portfolio.

In slide 8, we have our interest earning portion of the net interest income. Basically, we had a reduction pro forma nine months of 6.7% and year-on-year in the quarter of 8.1%. The credit intermediation margin was mainly impacted by lower volumes. This is basically also the main impact on net interest income as a whole while spreads are relatively flat.

The insurance margin improves in this quarter as we had (00:09:12) last quarter basically with the impact of a higher (00:09:18) that is recognized from our own portfolio. In securities and others, we had a reduction this quarter. We didn't have the impact of dividend. (00:09:33) fourth quarter.

In slide number 9, we have the credit intermediation margin. The credit margins or credit spreads still remain consistent. We had a slight increase in the quarter. After provisions, we have an even bigger increase in margins. We think this should remain as the trend for next year. In slide number 10, the expanded loan book, we had a reduction in the loan book in the quarter of 1.4%. The Individuals portfolio showed a bolstered performance, increasing 0.1% Q-on-Q. We think that this is the beginning of a better trend. The company portfolio still reduced 2.1%.

Year-on-year, we had a reduction of 6.7% in the total portfolio, for individuals, plus 0.7% and companies, minus 10.3%. And in fact, in the individuals portfolio, we see more consistency, (00:10:59) see recovery in most of the lines, even car loans which have been reducing for a few years presented this quarter a better trend.

Looking to loan origination, in the quarter year-on-year, individuals loan origination increased 35% compared to the third quarter 2016, and we have 21% in loan origination in companies. For companies, we still have to see further increases in loan originations for first balance the (00:11:40) portfolio and then start to grow again.

In slide 11, we have probably one of the best news we have seen in the first quarter. Credit quality trend remain positive. We have the reduction of 41 bps in the NPL for SMEs, 41 bps for individuals. We had an increase of 28 bps for corporate cost by a few cases, while the total NPL reduced 17%. Despite this pressure on corporate, we believe the trend for total NPLs remain positive as the NPL formation from corporate doesn't have a big impact in the total NPL.

In 12, we have our 15- to 90-day delinquency ratio. In the slide 13, which show the NPL formation, basically, we have another reduction this quarter to BRL 5 billion from BRL 5.2 billion. Our gross provisions cover the 100% of the NPL formation in the quarter.

Our loan loss provisions net of credit recovered reached BRL 3.8 billion in the quarter, another reduction in the quarter reaching 4.14%. As we have been saying, we believe we still can continue improving this provisioning ratio during 2018.

In the slide 14, we have further details of our NPL creation. We have improvements in the SME portfolio, in the individual portfolio and a small increase in the corporate NPL formation to BRL 0.8 billion.

In slide 15, we have our provisioning ratios. Our total provisions reached 9.9% of our loan book with our excess provisions remaining at BRL 6.9 billion. Our 90 days NPL coverage expanded from

202% to 208%. We think we have a very consistent provisioning level and we think this coverage can actually continue improving in the coming quarters.

In slide 16, our renegotiated portfolio, basically we brought this quarter a new information that is the renegotiated portfolio considering only loans that were still in our book discounting the credit recovers that also go to the renegotiated portfolio. So considering the total renegotiated portfolio, we have the reduction of about BRL 100 million considering the renegotiated portfolio without the recoveries, basically the reduction was bigger and has been happening in the past two quarters.

In slide 17, our fee and commission's income. Basically, we had a increase of 5% in the quarter year-on-year, 4.3% Q-on-Q. We think our numbers are consistent. We are showing good performance in asset management, consortiums, brokerage and investment bank. And we believe we still have room for continued capturing synergies from our acquisition, we already see some positive impact, but we think more benefit will come throughout next year.

In slide 18, another very positive story that is the operating expenses which showed a reduction in total operating expenses of 3.9% Q-on-Q in the third quarter, considering pro forma nine months a reduction of 3.1%. Basically, we have a strong reduction in administrative expenses, 5.8% where we were able to capture already a big portion of the synergies, renegotiating contracts, shutting down the IT platforms form HSBC.

And we think we still have benefits to capture on the administrative expenses that we are still in the process of reducing branches that overlap with our acquisition. We reduced 223 branches this quarter, and the reduction in 12 months amount 492 branches and we believe we still have room to continue adjusting. There is a portion of adjustments from the overlap in the fourth quarter and going ahead adjusting according to the evolution of our client needs.

In the personnel expenses, we already had a good performance but the benefits from the Voluntary Severance Program are not reflecting in this quarter since most of this 4,500 people left the company in the end of the third quarter. Most of the people that joined the program will leave the bank until the end of the year. Some, probably until February. So we still have benefits these coming quarters from cost reduction.

In slide 19, we have our efficiency ratio. As for the 1.5%, the operational coverage ratio of 75.9%.

In slide 20, we have the numbers from our insurance company. We remained with good performance in terms of premiums. Our premiums are growing 5.1% year-on-year in the third quarter. Pro forma nine months present an increase of 6.7%. Net earnings for the insurance company increased 16.8% Q-on-Q with the return on assets reaching 20.9%.

In slide 21, we have the information on our capital. We've continued adding capital on organic basis. As Alexandre mentioned, we added 19 bps in (00:19:21) capital this quarter. We believe we should continue seeing an evolution of – in capital from earnings retention going ahead. Our common equity capital ratio was 12.4%, total Tier I, 13.3%, considering our fully loaded calculation.

And finally, in the slide 22, we have our guidance. We keep the guidance unchanged. Basically, we have some challenges here for the expanded portfolio. We believe we can reach the bottom. I think it's feasible.

In the net interest income, it's more challenging, but we believe we probably would be close to the bottom of the guidance. Fee and commissions probably center or center high. Expenses, we are more to the lower portion of the guidance, especially considering the impact of the Severance Program.

Premiums, we are doing fine there. And allowance for loan losses and expenses, the guidance is BRL 18 billion to BRL 21 billion. We believe we are going to be in the bottom or eventually slightly better. So, with that, I conclude the presentation and now I open for questions.

Q&A

Operator

Thank you. Ladies and gentlemen, we will now initiate the questions-and-answer session. Our first question comes from Mario Pierry of Bank of America.

You may proceed.

Q - Mario Pierry {BIO 1505554 <GO>}

Good morning, everybody. Let me ask you two questions, please. The first one is related to your net interest income guidance. You're saying it will be challenging already to meet your full-year guidance, but you had reduced your guidance in the previous quarter.

According to our numbers here, your net interest income is down about 10% in the first nine months of this year versus last nine months last year. You're guiding for minus 5% to minus 1% – or originally, I think, as 0% to 4% (00:22:15). So my question is what is surprising you on the net interest margin – or net interest income that you have been revising down your forecast? So that's question number one.

Question number two is related to your fee income generation. I think it has been a little bit weaker than what we were expecting. You had originally guided that you expected to see synergies from the HSBC transaction of roughly BRL 1.1 billion in revenues.

But when I look here at your number of these active accounts, I see the number of active accounts fell from 27.2 million people in September 2016 to 25.8 million in September 2017. So can you just talk about, then give us more color on what's going on in terms of revenue synergies which has been seen in your ability to maintain the clients that you acquired? Thank you.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Thank you, Mario. First, starting on the net interest income guidance only to remind the guidance is for the net interest income from interest that is dropping 6.7%. We feel it's a challenge. We would need for NIM to bottom something like 7% growth in net interest income in Q-on-Q. The main point that has been impacting net interest income are loan volumes. Basically, we were targeting the center but the recover actually is happening but in the third quarter probably lower than we expected, especially in companies or in companies mostly. So, this is probably the main challenge.

Another thing I call your attention is considering the asset liability management from the bank part of the results from net interest income actually end up (00:24:52) and we recognize these results as we accrue interest from the bonds we have there and we have strongly a positive market to market in the past few quarters.

But as I said, it's possible, but margins itself seems a little bit challenging. Volumes, less challenged, with relatively modest growth would be in the bottom of the volume guidance. But basically volume is the main source of challenges there.

Regarding fee, I'd say when you look to the loss of clients, the debt reduction is not basically that we are losing clients we acquired from HSBC. The main source of loss is unemployment. We are a bank that is very strong in payrolls.

We have relationships with companies and their employees (00:26:15) salaries in Bradesco with the unemployment that leads to some reduction in the number of accounts. This is one of the challenging piece as a whole. It doesn't relate necessarily to difficulties in HSBC.

Regarding HSBC, we feel we are doing fine. We also suffer with the still relatively weak economy, but looking for instance a number we have very precisely that is the low origination per client from HSBC, we are seeing a pretty good evolution with low origination per client reaching numbers that are close to the average from Bradesco. So, it's progressing, as we have been saying, we believe we may be - we will be able to capture these full synergies until the end of next year.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Let me go back, then, to the net interest income. Because I remember in our recent conversations, you were very confident that you would be able to maintain a net interest margin stable at least through the second half - through the first half of 2018, because of benefits to your funding cost from a lower interest rate environment. Is that still the case or are you getting a little bit more uncomfortable of the margin outlook as we go into 2018?

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

I think, realistically, we can assume from stable to slightly down. I think it's more realistic at this point.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. And then finally, one follow-up on HSBC. Can you just - do you have a number that you can provide to us about the retention rate of the clients that you acquired or the retail clients that you have acquired from HSBC? And how much of the BRL 1.1 billion in revenues that you're expecting to get in synergies? How much of that has been realized?

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Mario, first of all, we are not sharing these numbers. I can tell you that we didn't experience a material loss of clients since we finished the integration of systems or since we assumed HSBC in July 2016. Most of the losses happened actually before we assumed the bank. But we can tell you we are progressing. We think - as I've said, if loan origination is kind of a reference, in that case, we are really - we had a material increase from the levels we saw when we assumed HSBC.

A - Alexandre da Silva Glüher

Mario, as a complement, we considered some group of HSBC regional clients. And when we compared these groups with our similar group of regional Bradesco clients, we have seen, in some groups, almost the same level of profitability. In some groups, we reached 70% of the Bradesco profitability of clients. And in other groups around 9%. Then there is space to grow more and to be more efficient in these relationships with them.

Q - Mario Pierry {BIO 1505554 <GO>}

Okay. Thank you very much.

Operator

Our next question is coming from Carlos Macedo of Goldman Sachs. You may proceed.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Hi. Good afternoon, gentlemen. I have a couple of questions. First, I want to go back to talking about margins. Your credit margin, as you showed, now 13.3%, were up this quarter. And I think

Firetti was talking before about how your net credit margin, which is 8.2%, that went up 40 basis points, I expect that to stay at this level.

Just going back to what Mario just asked, I mean you have – your cost of risk is pretty much at the lowest level than it's been in several years, pretty close to where it was in 2014, 2015 – 2014, so typically when across – when things were much better. There might be a little bit to improve, but not that much. And you still haven't seen the effect of the lower rate in spreads on your credit margin which should contract. Do you really think that that can stay at 8.2%? Do you think that will go to 7.0%, (00:31:28) 7.8%, 7.5%. How far do you think it can get? I don't mean this year, meaning more in the medium term, say, by the end of next year given the outlook stays like this.

Second question, the loan portfolio for – on the consumer side increase sequentially. I think it was the first sequential increase in auto loans since 2011 which is a very big shift, I would say. Obviously, you saw conditions have improved and allowed you to be more aggressive or take more risk. Do you think that there's something in the horizon for the SME book which is one of the books that really suffered over the last 18 months that could allow you to start growing that book again over the next, maybe, couple of quarters? Thanks.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Thank you, Carlos. Regarding margins and also you related to cost of risk, looking to our portfolio and especially looking to our loan vintages and the level of new cost of risk originated from these vintages. We feel we can still continue improving gradually for some quarters. Remember that even though we have already improved, we are still higher than what we see as the bottom. And on top of that, remember, the mix shift to lower risk, so we have been changing the mix to lower and lower risk for a few years.

But actually, given the crisis, the cost of risk increased, not improved. So, we feel we still have room for improving cost of risk.

In terms of margins, basically as I've said, we have some impact from depositions in our asset liability management, some fixed rate positions in the loan book and some gaps. We should have some benefits from that. For sure, the reduction in the SME book that is a fixed rate portfolio and reduces a little bit of the impact of that compared to other moments (00:34:20). But that is still there. As I've said, there are also (00:34:25) to be accrued to the margins in the (00:34:34).

We don't see any pressures in spreads. We do believe that as the economy improves, we may see some correcting (00:34:46) spreads, but we don't think there will be any disruption in spreads. It's more a gradual adjustment as probably volumes improve. So, we believe these will be coincidences improvements in volumes.

Then, linking that with your question on loans, we are seeing kind of a wide spread recovery in the individuals portfolio, which this time (00:35:15) in the origination of improving almost all credit line. Even personal loans, we saw the first growth, as you said (00:35:25) loans in the years, and we feel that this trend should remain. Probably we will continue to see improvement in the individuals portfolio.

In companies, it's a little bit more challenging given that – even with the recovery in the economy, actually companies are more recovering inventories, basically enjoying a better moment than actually starting investment phase.

But even with that, we still – (00:36:05) as sales grow as company start to sell more, the increasing volumes of receivables actually creates the base for more lending. Especially for SMEs, the ability to grow with clean credit lines is limited. The cost is too high. The risk is too high. As we have more receivables as the economy picks up, that creates the base for – maybe growing more even in the SME portfolio.

A - Alexandre da Silva Glüher

One important strategic point is that we are looking for volumes of course in credit. But we are focused on quality, more in quality than market share. Then we are selective (00:36:59) to give credit, to produce credit, as I said looking forward, volumes (00:37:09) reaching better levels of quality.

Q - Carlos G Macedo {BIO 15158925 <GO>}

Okay. Perfect. Thanks for (00:37:17) gentlemen.

Operator

Our next question is coming from Jorge Kuri of Morgan Stanley. You may proceed.

Q - Jorge Kuri {BIO 3937764 <GO>}

Hi. Good morning, everyone. Can we just go back to margins? I'm sorry. So your net interest margin as you reported on the interest portion of your assets excluding training and terminal (00:37:46) assets was 6.9%, that's down from 17.2% in the previous quarter. So there is an acceleration in the contraction in margins down 30 basis points this quarter versus 20 basis points in the previous quarter for the first nine months of the year down 60 basis points.

So given your asset sensitivity and the fact that past (00:38:18) interest rates continue to come down and your back book will be priced at lower rates. What do you think when and at what level did you think your margins are going to bottom down? So you are at 6.9%, how much more should that go around and when is that, what quarter of next year do you think that will reach the bottom? That's my first question.

And then on the second question, I'm going back to a third question that Mario made on HSBC. If I look at your operating results pre-provision, for the first nine months of this year which include HSBC, compared to the first nine months of last year excluding HSBC, that number is down 5%. So I'm just wondering where is HSBC. And if I look at Itaú, for example, with no acquisitions, their first - and they've (00:39:31) even more asset-sensitive. Their nine months pre-provision operating profit went down 2%, (00:39:40) down 5% and you added a whole new business.

So I'm just trying to figure out where is HSBC and when are we going to see some of the benefits. (00:39:49) said that it is going to be fully consolidated in six months and hasn't - I mean I don't know if it's played (00:39:54) out or not. So maybe can you tell us what was the contribution of HSBC to your operating results in the first nine months of this year? Thank you.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Thank you. Jorge, considering margins, despite this reduction, as I said, we have few results to be recognized in margin that were actually (00:40:32). And this is going to be - this interest will be accrued as we converse through the mature results of this launch (00:40:46). So basically, we believe that margins, nothing else happening, probably should (00:40:57) by the end of the year or along the end of the year. I think that's when all the actual liability sensitiveness from our balance sheet (00:41:14) most of it is actually gone.

For the following years, there's a lot of moving parts, not exactly on the margins, but as I said, (00:41:28) next year volumes will be better, and depending on how things progress, we believe my team could be even on better year (00:41:42) the portfolio, so - but basically strictly (00:41:48) on your questions, probably, the (00:41:51), we will not be - the reduction is not going to be (00:41:56). It's going to be gradual, especially, due to the recognition of gains from our asset liability management for business.

Regarding HSBC, basically, the thing is we have a lot of moving parts. The economy from the – actually hasn't been helping in terms of – since we incorporated HSBC. It's starting to improve only now. We have been doing a good job in terms of cost reduction and that is not fully reflected in the numbers this year actually. Since we have been advancing a lot in the cost side, in the past few quarters. Actually, the benefit from the cost reduction we will actually reflect more next year. Even this quarter, where we (00:43:11) program where almost 4,500 people left. Actually, they left at the end of the quarter. There is no major benefit reflected there.

Also, we closed branches throughout the quarter. So, on the cost front, we are doing the job that capture (00:43:33) meaningful amounts of synergies. On the revenue front, basically, a big part of the synergies come from talking client-to client and convincing (00:43:55) better services and charging for it. It has been a challenging environment. And as we said, the process is moving, but we couldn't go faster than expected.

So, basically, we believe we can still capture meaningful synergies (00:44:19) HSBC until the end of 2018. That is actually what we have been saying. We were actually able to do faster than expected, the capture of synergies on the cost front. But actually, on the revenue front, it's going to be – it will take a little bit more time.

We did already see (00:44:44) good results in terms of increasing origination of loans for clients because something that as loan growth picks up, we believe it will be a important source of growth. But so far, we are in the process of capturing the revenues on the service side.

Q - Jorge Kuri {BIO 3937764 <GO>}

Thanks, Carlos. If I just may follow up on my first question. So you said the bottom of margins end of the year, maybe beginning of next year and I also asked how much more are there (00:45:34) coming down, since the 6.9%, what do you think the bottom is, what level? (00:45:42).

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Yes. I prefer, let's change a little bit the way we refer to this because certainly, it's more aligned with the way we present our guidance, not in terms of margin, more in terms of (00:45:59). This year, we – the bottom of our guidance for margin is minus 5%. (00:46:10) lower than that. For next year, we believe NII may be from stable to somewhat down or slightly down. So that's what we expect for NII. You can translate it to the NIM (00:46:33).

Q - Jorge Kuri {BIO 3937764 <GO>}

Great. Thank you very much.

Operator

Our next question is coming from Marcelo Telles of Credit Suisse. You may proceed.

Q - Marcelo Telles {BIO 3560829 <GO>}

Okay. Thank you for your time. I have a couple of questions. And I think the first one is actually a suggestion. I think it's caused me a lot of confusion in terms of the NII analysis from what I've seen from the questions before regarding the impact of the impairment. So I'll recommend to put the impairment losses in the provisions (00:47:19) because I think it's causing quite a bit of confusion. I mean for instance, if you look at your pre-tax earnings – pre-tax to (00:47:32) earnings in the nine months of the year (00:47:35) down 5%, it's actually flat. Because the impairment isn't a bit in line (00:47:40). So I just need a little help (00:47:42) understanding better the NII trend.

But in that point, I just want to also reconcile the dividend that you guys received compared to twice a year from one of the (00:47:59) that you have. I understood this business is quite material and you achieved in second quarter, but you did not achieve in the third and very likely you going to achieve this (00:48:09) fourth quarter, right. And this is something that you guys received every year.

So if you could elaborate on that, if that can also explain the impact, I think, it could be some hundreds of millions that could be reverted in the fourth quarter. So if you could explain that and clarify that, that'll would be good.

And my other question is regarding the loan growth. As you mentioned, you expect better loan environment next year. How much of the loan growth you think you'll be able to achieve next year? Do you think, like 3%, 4% sounds like a good number? And more specifically, in terms of your SME book, I know it has been declining steadily as you have been de-risking, when do you think we should start seeing growth in the SME open (49:02)? Thank you.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Thank you, Marcelo. Regarding the impairments, we think you are right. We kept the impairments as we are reporting that is actually the right way, considering the accounting place, the impairment should be. But on (00:49:28) point of view, probably it's better to have it together with the cost of credit, and then we will do that next year. We dispersed off all that in the middle of the year when changing the guidance, but we felt that changing that probably would create even more confusion, so we decided to keep it for this year and change it probably for next year. But thanks, we think you are right.

Regarding the dividends from the Bradesco BBI investment, what we can tell you, it is received twice a year. You can't take that for granted. The quarter when we receive it depends not entirely on that, it depends on the company that is paying and the (00:50:27). So we didn't receive it this quarter, it's going to be in the fourth quarter, To avoid confusion, the best we can say is (00:50:41) twice per year, one first half, one second half...

A - Alexandre da Silva Glüher

By contract.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

...by contract, but we cannot really give too much precision on which quarter it will be (00:51:01). And we received this year once, in the third quarter – in the second quarter.

Basically, in terms of loan growth, we need – our economists basically believe loan growth for next year for the market should be something like 5%. If that's the case, surely we would be growing something like that or slightly better. So, that's a reference. Certainly, it seems that individuals will be leaving the pack and this company's portfolio comes up.

Yeah, but it's not a formal guidance, only a reference on what we believe for the market as a whole. We got the news, as I mentioned, we believe that growth in SME is largely dependent on (00:52:15) more demand, or more sales, or more receivables, high-quality receivables that backs the spread lines where we can really operate with more volumes.

We think that we are going to be seeing that probably partly in the first half next year. We believe that on a Q-on-Q basis, probably maybe first half next year is a good target for us, starting to see some recovery in growth in SMEs, maybe first quarter.

If you see, this quarter, the SME portfolio, actually, the reduction deteriorated. It was still a meaningful one, 1.8%, in the quarter. It was actually lower than for large companies. We think this new reduction probably will continue reducing fourth quarter (00:53:28), maybe some better performance there, but really we are still seeing - we've seen improvement. As I mentioned, if you look to lower origination of three credit lines in the third quarter comparing to third quarter 2016, there's a growth of 21% year-on-year. So origination is improving. We still have to see more, higher growth in these originations to lead to an equilibrium in the portfolio.

Q - Marcelo Telles {BIO 3560829 <GO>}

Thank you. Thanks for the answers. Just one final question if I may. Regarding your insurance business, in particularly the (00:54:27) results of insurance, when you look at the numbers, we did see still relatively a high loss ratio that we still have back in 2014. So how should we think about your insurance business down the road. I mean, with the economy improving, (00:54:49) group. Could that be aligned with a potential supportive surprises down the road? Thank you.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

I think The most important (00:55:05) in terms of loss ratio comes from the health insurance, that actually we suffered with the economy. We lost clients during the process. There was an impact from unemployment. But as unemployment reaching the peak, even if it stabilizes and the economy improving, we believe loss ratio in health insurance can improve materially. This quarter, there was already a meaningful improvement in the loss ratio for health insurance. It's basically - it helps and we think we will see more consistent numbers in improvement in the health insurance in the coming quarters.

Q - Marcelo Telles {BIO 3560829 <GO>}

That's very helpful. Thank you.

Operator

Our next question is coming from Philip Finch of UBS. You may proceed.

Q - Philip J. Finch {BIO 3252809 <GO>}

Good afternoon, gentlemen. Thank you for the presentation. Two questions for me as well. First of all, regarding your capital position. Clearly, you've been rebuilding capital very well since the HSBC acquisition. I just wanted to know at what level of capital, the Common Equity Tier 1 ratio would you want to reach before you start to think of deploying more capital to shareholders, i.e., raising your payout ratio?

Second question is related to your asset quality and specifically, cost of risk. Again, very good progress on this front, especially in the latest quarter with cost of risk coming down significantly to around 4%. So the question is, how much lower can we go especially given the loan competition today is very different from what it used to be being a lot more defensive or conservative. So, how much lower can we go? And also, how quickly? Thank you very much.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Okay. In terms of capital, basically, we have been adding capital organically, sequentially. Our fully loaded ratio including the estimates for use of tax credit and goodwill amortization is 13.3% Tier 1, 12.4% common equity and it's a still a good level. Basically, we don't have at this moment plans of changing any of our policies in terms of capital deployment. We are still in the final steps of the implementation of BIS III. We believe we cannot had, potentially grow more.

So we probably will to add being a little bit more capital organically until the end of next year. But that said, we actually have been paying more dividends. If you look through our current payouts, considering we have been paying interest on capital at full, it has been higher than 40% and it's quite good. Basically, we don't have a cap for this event. We never had. So basically, there's always streak selling in paying more. So probably we should - also the base of population for paying dividend is (00:59:28) earnings, that still has the impact of goodwill amortization, but it's - we think, we should add a little bit more capital through (00:59:45) from next year.

And regarding asset quality, how low it can go with? As we said, had the change in mix. We - even with this change in mix, given the cycle, we had actually an increase in the (01:00:11) ratio in cost of risk. And as we improve our credit quality, see that our new (01:00:21) are performing better - still performing better than the current levels.

We think it still has room to improve. We don't have with a target but it wouldn't be - it would be possible to actually at some point, at the end of next year to meet very low historic levels.

Q - Philip J. Finch {BIO 3252809 <GO>}

Okay. Thank you very much, Carlos.

Operator

Thank you. Ladies and gentlemen, since there are no further questions, I would like to invite the speakers for their closing remarks.

A - Carlos Wagner Firetti {BIO 2489005 <GO>}

Okay. Thank you very much all for participating in our conference call. The Bradesco's Investor Relations department is available for answering any other question you may have. So thank you, all.

A - Alexandre da Silva Glüher

Thank you.

Operator

That does conclude Banco Bradesco's audio conference for today. Thank you very much for your participation. Have a good day.