Banorte

Third Quarter 2020 Financial Results

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CORPORATE PARTICIPANTS

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PRESENTATION

Operator
Good day, and welcome to the Banorte's Third Quarter 2020 Earning Conference Call. All participants will be in a listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star (*) key followed by zero (0). After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star (*) then one (1) on your touchtone phone. To withdraw your question, please press star (*) then two (2). Please note this event is being recorded.

I'd now like to turn the conference over to Marcos Ramirez, CEO. Please go ahead.

Tomas Lozano
Good morning. I am Tomas Lozano, Head of Investor Relations, Financial Intelligence and M&A. I am happy to meet you again. Welcome to Grupo Financiero Banorte's Third Quarter Earnings Call. Today's presentation may include forward-looking statements subject to risks and uncertainties which may cause actual results to differ materially. We ask you to take this into consideration. Our CEO, Marcos Ramirez, will provide an update on the effects of the partial reactivation of the Mexican economy, the outcomes of the initial set of customers that came out of the relief programs as well as the main financial performance results. Later on, Rafael Arana, our COO, will provide further detail on our financial and operating results, and we'll share some additional color on our expectations for the rest of 2020.

Finally, we will conclude our call with a Q&A session. I would like to take the opportunity to encourage you to participate in a very short survey aimed to get your feedback in order to improve our presentation and the information we provide. Of course, during times like these, being closer to our investors and analysts is key. Thank you. Marcos, please go ahead.

Marcos Ramirez Miguel
Thank you, Tomás. Good morning, everyone. Thank you for your interest in Banorte and for joining our call. After a volatile and uncertain first half of the year, the third quarter of 2020 brought some positive news for our country and consequently for the bank. After reaching its peak in late June, the number of new COVID-19 cases and casualties have been slowly declining and economic activity has partially resumed. The first industry to reactivate were those linked to manufacturing for the supply chain with the U.S. and Canada as well as mining and construction. The tourism sector, which was broadly hit by a full shutdown for several months, has also seen a gradual recovery with occupancy rates reaching close to 40% in important touristic destinations such as Los Cabos and Cancún. The entertainment industry has seen a slower and more scattered recovery. Some restaurants and shopping malls have reopened, some with certain capacity restrictions and reduced hours of operation. Whereas some other sectors like theaters, sports arenas and other large venues still remain closed. Schools and universities still operate remotely. Home office is still widely adopted by most medium and large corporates. Depending on the number of new cases and casualties, the states in Mexico have red, orange or green flags that dictate the degree of reactivation that this allowed for different sectors. The largest cities, including Mexico City, are still partially restricted with orange flags until further notice.

Government support has been limited to certain programs provided by the Ministry of Finance and the CNBV that facilitate loan restructuring for the banking sector, specifically for individuals and SMEs. After a diligent analysis of these new facilities and their potential benefit for our clients and for the bank, we are more inclined towards not adopting them as we consider that our existing restructuring mechanism provides better clarity of the real condition of our balance sheet. The final decision will be timely communicated to you and to the banking regulator. In an effort to contribute to the economy reactivation, the government recently announced an infrastructure program consisting in 32 projects in different sectors for a total amount of MXN 260 billion, equivalent to 1.2% of the country's GDP.

I would like to stress that Banorte is ready to participate in these projects, and we will leverage on our expertise in infrastructure lending. The economic implications of over 6 months of the COVID-19 crisis still points towards a minus 9% GDP contraction in Mexico. In terms of inflation, we still expect to end the year close to 4%, although there has been some inflationary pressure that may still leave the door open for one more cut to the reference rate in November. Later on, if you want, Gabriel Casillas will provide further detail.

Switching gears, I would like to give you an overview of the most recent developments and results for the bank. The bank has maintained seamless operations with the majority of our branches and ATM network fully available for all our customers. We continue to enforce strict sanitary measures to ensure our personnel and customer safety. Furthermore, over 70% of our corporate office personnel is still working from home until we have better conditions for a partial return to our offices. As you know, back in March, Banorte was the first bank to announce a relief program for our consumer and SME customers, and we have been working thoroughly to ensure that they resume their payments on time. I'm very happy to tell you that the outcome of these efforts has been better than expected. More than 60% of those who enrolled into the program have already ended their grace period, and over 91% of them have resumed their payment schedule. As I mentioned, this is much better than our initial expectations. Later on, Rafael Arana will walk you through the details.

On the digital side, as you can see on Slide #3, we strive to enhance the features and functionality of our digital channels. As customers continue to adopt our mobile and web channels, we have seen significant improvements in customer satisfaction as measured by our NPS in Banorte Móvil and our web services.

On Slide #4, after a typical second quarter in terms of provisions, profitability for the third quarter shows a stronger result with net income totaling MXN 8.9 billion, return on equity for the bank at 21.1%, and for the group, return on equity stood at 16.9%, mainly impacted by higher capital accumulation at the group level as we have not yet distributed the 2019 dividend. Rafael will revisit this in a few minutes.

Moving to Slide #5. Net interest income year-to-date had a robust 5% growth compared to that in 2019, driven by better spreads in our corporate and government books and supported by diligent efforts to improve our cost of funds. Moreover, trading income along with other operating income returned to a normal level in the third quarter. This -- on Slide #6, please -- we recovered together with that unfolding economic reactivation. There was an increase in core banking fees during the quarter and [unintelligible] transactions continued their upward trend as customers continue shifting their spending patterns toward online merchants and more frequent use of our mobile features.

As you can see on Slide #7, loan growth was driven by good dynamics in mortgages and consumer loans. Despite some prepayments in our corporate book, we have seen increased loan demand in this sector while government loans recovered compared to 2019. So, portfolio quality remains very positive, partially helped by the relief programs in place during the quarter.

Taking a deeper dive into our government portfolio, Slide #8. Notice that Banorte has had a higher share of the bidding processes awarded during the year as the spreads now have improved more than 50 basis points compared to those in 2019. We will still privilege profitability over volume, and these market conditions now are favorable for growth in this sector.

Our subsidiaries, in Slide #9, provided a solid contribution to the group's accumulated results. The bank's ROE year-to-date totaled 18.3% and excluding the effects of additional provisions in the previous quarter, it totaled 22%. The insurance business showed 6% increase in net income compared to last year. Moreover, our annuities business already incorporates the most recent portfolio acquisition from SURA, resulting in a 15% increase in pension allocations during the year. Additionally, our leasing business matched with Solida and now operates under the name of Arrendadora y Factor Banorte.

There are still challenges ahead. However, we now have more visibility of the evolution of our portfolios, and we remain very confident that our franchise will keep strong for the rest of the 2020.

Now moving to Slide #10, I will address a subject in which we have been heavily involved for many years, but that we have not mentioned explicitly in our conference calls, our ESG strategy. As you can see, we have been devoted to developing ESG since 2009, joining the Global Reporting Initiative, later on adopting the Equator Principles, signing the Principles for Responsible Investment and more recently, last year, we were 1 of the 28 funding banks that signed the Principles for Responsible Banking.

A quick overview on every aspect of our ESG initiatives. On the E side, Environmental, we have been quite active implementing policies to help our planet cope with climate change, such as reducing waste and increasing the use of electricity from renewable sources, to mention a few. On the S side, Social, the improvement of our human capital has been key in the past few years as well as our active participation in financial education and inclusion along with our long-standing community engagement programs. On the G, Governance arena, we have continued improving our Board of Directors selection processes, setting goals for a higher share of independent board members as well as developing our risk management systems in a more holistic way. We have progressed significantly in terms of sustainable finance. From now on, we will release updated information on several metrics on a quarterly basis, such as the number of analyzed projects under the Equator Principles and the percentage of banking loans that have been analyzed under the ESG perspective. We have included some additional slides regarding this topic, and Gabriel Casillas may also provide more detail during our Q&A session. With this, I conclude my remarks. Now Rafa will walk you through the details of our relief programs, provide additional color on our capital position and our expectation for the remainder of the year. Rafa, please, go ahead.

Rafael Victorio Arana de la Garza
Thank you, Marcos, and thank you everyone for attending the call. I would like to go on and continue the explanations that Marcos just mentioned as a framework for how the bank is doing and how we are operating. We know there is concerns about it, that if the number -- the size of the provisions that we have been doing -- that we did in the second quarter are going to be good enough for the remaining of the year, and I would say that that's a question that still has to be resolved based upon what's the evolution of the day-to-day operation of the collection and touching with our clients. As you can see on the slide that we are presenting to you, this is based upon what we are doing, all the provisioning and the highlights of our recovery and relief programs. As you can see now, up to September 30th, 64% of the individuals that got into the --

or SMEs that got into the relief programs now are out of the program. Our original expectations were that 22% of those were not going to be able to pay for the -- when they come back to the -- out of the relief programs. The real numbers now we are looking is 9%. It's a better number than we expected and anticipated. Based upon the provisions that we did on the second quarter was mainly based upon the 22% number, not on the 9% number. Is that – is this number going to hold – it is still we have to see that. We -- I think we have -- we will have much more clarity at the beginning of December, at the end of November, when most of the programs will come to an end. There also has been some questions about that if the mix that we will have on the third wave, because this is basically the first and the second wave, is the third wave going to be more risky than the first and the second? And the latest numbers that we just reviewed are showing us that are basically the same. We anticipated a more risky wave on the third one, but now, based upon the information that we have, we see that is basically behaving and performing like the first and the second one. So the numbers up to today are better than expected, still a long way to go, and rest assured that we will do whatever we need to do in order to provide enough relief on the provisioning side or anything that needs to be done. At this point in time, these are the numbers that are showing us that what we expected and did on the second quarter is good enough. Another important piece concerning some questions from analysts and investors is, what's the behavior on the NIM? And what's a sustainable number for the net interest margin? And there's a graph that can show you -- because when you look at the numbers on the margin, it shows a better-than-expected performance, and there is a specific reason for that. Can you hear me now?

Operator
Hello. Yes, we can hear you. Please proceed.

Rafael Victorio Arana de la Garza
Okay. So, as you can see on this slide, it's basically showing the main component of why the margin has been so resilient. The first one to the left, on the blue lines on the graph, what it shows to you is the cost of funds have been decreasing, so sustainable through the last year and this year. Based upon that, we have now almost no external funding. That was in a point in time [technical difficulty]. Sorry, I think we lost the line, so I will restart the NIM slide. The slide basically shows why the NIM has been so resilient. As I mentioned to you, the blue lines show the cost of funds decreased against the competition and against the market. We have been quite efficient in decreasing the cost of funds. We have got rid of some expensive funding that we needed in order to balance out the acquisition of Interacciones, and the NIM of the loan portfolio continues to move upwards from 8% to 8.1%, okay? [technical difficulties]

Operator
Pardon me. This is the operator. Please hold while we get the speaker line reconnected.

Then once again, we just kindly ask you please remain on the line as we reconnect the speaker location.

Gabriel Casillas
This is Gabriel Casillas. Rafa is reconnecting, so could you please hold on one minute, we would really appreciate that. Thanks very much.

Rafa is almost here, he went to take another phone line in order to have better reception. Thank you, thanks for waiting.

Unidentified Speaker

Yes, thank you.

Operator
Pardon me, we have reconnected the main speaker line. Pardon me, I have the conference moderator on the line. Please proceed.

Rafael Victorio Arana de la Garza
Yes. So, we were reviewing -- I don't know where we lost the line. We were reviewing the Slide 13, where we were just showing the resilience of the NIM and why the yield on the portfolio and why the cost of funds has been improving substantially for us and against our peers. When we go back in detail into the net interest margin, basically, what you can see is that the net interest margin continues to hold at the bank's level even though the reference rates have been going down to 132 basis points. It explained exactly what we mentioned in the previous slide. That has to do with the cost of funds, a much better improvement on the yield of the portfolio against the peer under a very challenging environment of declining interest rates. You can see on the graph to the right that the NIM continues to be steady, and there have been questions about what we can consider that is a sustainable margin on the going forward? And we have been looking at numbers of 5.5% to 5.6% for the bank, okay?

If we continue to the next slide, there is also always the concern about what's the evolution of the -- and the sensitivity on the balance sheet that has been reduced substantially in the past 2 years? In the past, 400 basis points, was close to MXN 1 billion, now we have, with a much larger balance sheet, MXN 504 million of sensitivity. This has to do with a lot of -- how we have been managing the hedging process on the balance sheet, and there is a very important number that we can provide in this. In September of '17, when we have a fixed rate portfolio of MXN 220 billion, the margin on the balance sheet was around 9.9 with very high interest rates. Now if we move back to September '20, of this year, the fixed rate portfolio is close to the MXN 300 billion, but the most important piece is, the margin, the accumulated margin on the balance sheet has grown from 9.9 to 11.1. This has to do with this hedging strategy that we have been implemented in the past 2 years.

If we move now to the next slide. There is also -- when you see a decrease in the pace of the revenue, basically, you have to look at your -- how your cost evolution is moving. In this graph, what we are showing to you is that we think we will end the year around -- in the range of 4% to 4.8%. We will maybe front-load some expenses at the end of the year because as you know, we usually -- at the beginning of the year, we do productivity analysis concerning the -- which people is nonconforming to the productivity that we expect. So we basically -- we will front-load some of these provisions for the end of the year, and also the decline on the revenue side is also putting some pressure on the amortization projects that we had in the past. Nothing to worry about, but we will return to revenue growth and match those expenses again, but as you can see, personnel expenses are well under control, 1% growth, and the remaining is what is giving us the range around the 4% to 4.8%, okay? This put us on an efficiency ratio at the end of the year, close to 40% for the group.

If we move to the next slide. It will show you the numbers that are also -- a lot of questions coming from the investors and analysts, what's going on with the capital ratio and the dividend policy? As you can see, the capital ratio continues to increase substantially from a quarter-to-quarter close to 50 basis points from 13.2% to 13.7% core Tier 1, and what is important to mention here is that this 13.7% is without the dividend that has already been warehoused at the group level. So, the 13.7% is without the MXN 16 billion of dividend that is now warehoused at the group. So, we continue to see a continuous evolution of the capital, and this has to do with the architecture of the group, where we have very efficient subsidiaries on our capital numbers and on our fee-based numbers that allows the bank mostly to be on its own to build up its capital. So, the architecture of the group is also helping us to keep a continuous evolution on the capital ratio. Concerning the dividend, as you know, there was a recommendation by the authorities not to pay the dividends or to do buybacks. We are -- we present that to the Board and the Board to the Assembly, and they agreed to warehouse the dividend, not to cancel the dividend in any way but to postpone the dividend, that part. So, that's what we are doing. We are talking with authorities in order to present the evolution on the numbers on a liquidity basis, on a capital basis to show that Banorte has a very strong balance sheet to support the evolution of the pandemia and still comply with the promises that we have with our investors.

Next one, please. On liquidity, there also has been some questions about liquidity. As you know, in the past, our liquidity ratio was always around 125%. We were sometimes in the low end of our peers, but this has to do with efficiency because, obviously, liquidity has cost. At this point in time, we decided to raise liquidity. As you know, we issued an AT1. That is also helping us to raise the liquidity. Now liquidity is sitting at 194%. I think it's a record-level on this, but I think it goes with the times. I think we will feel much more efficient around 130%, but at this point in time, I think it's worth to have additional liquidity ready for us, and there also has been some questions concerning of the facility that has been quite useful from this -- from the Bank of Mexico, but what's the usage of those lines? As you can see on the graph that we are showing you, there has been almost no usage of those lines. It's good for us to have that facility -- good facilities, but at this point in time, there has been almost no usage of that. So, the bank has sustained its liquidity on its own strength and base, and -- but we have an additional possibilities on -- with the central bank that we can use if we need to do so. At this point in time, we have not been in a need to use those lines, okay?

There are also always the questions about what's going on? What's going to be the end of the year? What's kind of the potential guidance that you can give us? And I would say that it's difficult for us to give you guidance concerning the net income numbers and also numbers concerning the cost of risk because our numbers, that move on a day-to-day basis. What we showed you at the beginning, that the 9% is much better than -- and we are showing a very strong numbers, as Marcos mentioned, in NPLs, 0.8%; our cost of risk, at record levels; coverage ratio of up to really very high numbers, but we know this is a work in progress, so we are not taking this as -- numbers as the run rates. We will go back to the usual numbers that we have I think at the end of '21. We will see a continued deterioration of our portfolios I think in the fourth quarter, to go back in the numbers that we used to have before, and peak, as I'm sure Gabriel will add to this in a bit, in the second and third quarter of '21, but this is considered in our models and is considered on the provisions that we did, but again, if we need to go and we see that deterioration goes beyond what we expect, Banorte has the balance sheet, the capital, the strength, the income to provide additional provisions if needed.

Obviously, those are always the concern, why you don't anticipate that? Because we think that based upon the information that we have, we are doing what we need to do, and we have the surplus of the capital that we have under liquidity and the balance sheet and the revenue stream to support whatever comes on that pace, but we need to have the right information and not anticipate or not be on the right track concerning the provisions. So expense control will continue to grow; loan growth, I think we will be around 6% to 8%; expense growth, as we mentioned to you, 4% to 4.8%; tax rate, a little below the usual rate because of the additional provisions that we did in the second quarter, and on an estimate of GDP of 9% to 11% -- minus 9% to 11%; inflation of 4%; and potential reference rate going back to -- going down to 4%. There has also been a concern why we have been able to grow the loan book in such a severe contraction of that. On the consumer, we continue to see good growth on the mortgage, as Marcos mentioned. Car loans have started to wake up again to numbers around 5% to 6%. Mortgages will be around 10%. Credit cards will be flat, but a very important number to mention -- that Marcos mentioned is that the minus 13% of the government book, now it's positive 3%, based upon much better spreads, as Marcos mentioned, and also, something that is relevant, and I think it will show in the next slide, is the concern that what are the exposures to some of the sectors that have been heavily hit by the pandemia? As you can see, that's the exposure that we have with Pemex, 3.6% of the total book; suppliers, 1.6%; CFE, 2.1%, and that's the numbers. Suppliers, 0.4%; housing, 1%; commercial, 1.8%; and others, 1.9%; malls, 2%; tourism is 4.3%; and restaurants, 0.2%; and airports, almost nothing 0.1%, and at this point in time, what I would like to also give you, because there have been some -- a lot of questions concerning why corporate is growing so much, and why commercial is growing so strongly on that, and what's the exposure. So I will ask René Pimentel, our Head of Corporate, to give us color of exactly what's the -- what's on the ground with the companies, talking to them and exposures and what are the philosophies that Banorte has been holding in the relationship with this exposure that we have. So, René, if you can give us some color on this, please.

Rene Gerardo Pimentel Ibarrola
Sure, Rafa. Thank you very much for the call. Basically, it's been a challenging year for corporates, as you may imagine. Clients have been facing liquidity pressures due to the closing of the economy. Now having said this, as Rafa mentioned, we've managed to grow the portfolio 18% year-on-year, and it's been accompanied by a growth in deposits of around 21% year-on-year with these same clients. So, that's been a very positive development for our portfolio this year. Now this has been the result of several factors. I would say, first, a strong pipeline that we carried over since 2019. We managed to execute this pipeline in the first half of the year, but second, it also has to do with clients drawing their available credit facilities. As the pandemic began in March, clients have been looking to strengthen their balance sheets, to accumulate as much liquidity as possible due to the uncertainty, and third, I would say, is the devaluation of the peso during the period. Keep in mind that close to 25% of the loan book on corporates is in U.S. dollars. So, this has contributed to the growth that we're seeing this year. I would also add that in terms of the quality of the portfolio, it remains very good. NPLs, as you've seen, remained at 0.3%. You may recall that in June, we provisioned the nonperforming loans that we had on the balance sheet, but these loans had become nonperforming really in 2018 and 2019. So, we've had no new cases of nonperforming loans this year. Now the way we've achieved this is we've continued to work very close with our clients. We've implemented tailor-made solutions to address the pressures in liquidity that they have faced. As Rafa just mentioned, the portfolio is pretty well-diversified in terms of clients, in terms of sectors and regions, and we're actually beginning to see some signs of recovery in some sectors like manufacturing, industrial, real estate, construction, some parts of the infrastructure, but we're still seeing some pressure in hotels, tourism in general, commercial real estate, some retailers and energy are the sectors that are being more hit. We feel very comfortable with the type of clients we serve. Many of them are leaders in their own sectors. They're very well-diversified themselves, and most likely, many of these will be looking for consolidation opportunities in the medium term, and we will be there to help them out. Going forward, we will be -- we will continue to be very selective as we do not have a lot of certainty of what's going to happen. We will favor the quality of the portfolio overgrowth. Our clients are mostly holding off on expansion projects, and therefore on new financing decisions. So, this is not to say they we're out of the woods. It's important to say that if we face a new and sustained closedown of the economy, we could see some added pressure in this portfolio. Now having said this, we will continue to be very close to these clients. We are in a very good position with a very strong balance sheet to help them navigate through the waters and whatever may arise. Thank you, Rafa.

Rafael Victorio Arana de la Garza
Thank you, Rene. So now we open the -- for Q&A.

QUESTIONS AND ANSWERS

Operator
At this time, we will begin the question-and-answer session. To ask a question, you may press star (*), then one (1) on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press star (*), then two (2).

Our first question today will come from Ernesto Gabilondo with Bank of America. Please go ahead.

Ernesto Gabilondo
Hi, good morning, Marcos, Rafa, and good morning to all your team. Congratulations on your results and thank you for your presentation. My question will be on deferred loans. As you mentioned in your presentation, 64% of your consumer and SME clients resumed payments in September and only 9% are delayed, which compares positively with the 22% that you were expecting before. So, my question is, for the remaining portfolio that will resume payments during the next months, I believe it's a riskier portfolio, so what will be your expectations for this portfolio? I don't know if delays could be around 10% to 15%? And then my second question is on what would you need to see to create more preventive provisions? Will this be related to the GDP growth, the unemployment rate or, the final, be a favor on the deferred portfolio?

Marcos Ramirez Miguel
Thank you much. Thank you very much, Ernesto, and Dr. Gerardo Salazar is going to help us with this. Go ahead, please, Gerardo.

Gerardo Salazar Viezca
Sure, Marcos. Hi, everyone. I would like to say the following regarding asset quality forecast. That's the question, Ernesto, that you're asking. Banorte has implemented a set of different measures to preserve the loan portfolio quality. Such strategies have been deferral and support programs for clients, most were restrictive loan origination standards in retail portfolios, and a case-by-case analysis in our commercial and corporate clients. Within the retail portfolio, clients for whom the support programs have expired, are showing a better behavior than initially expected, as Marcos was saying and also Rafa. Despite all the strategy aimed to preserve the loan portfolio quality, it will still be affected from then on by the COVID-19 crisis. We projected asset quality indicators under certain scenarios, taking into account the strength of our client, our credit process, collaterals and portfolio mix. We estimate the worst part of the crisis will be reflected in the second quarter of 2021 and the third quarter of 2021. Currently [unintelligible] ratio, as you have seen, is 0.8% at the close of September and after disclosing of PDL ratio of 0.8%, and we expect that indicator at the close of -- so at the close of this year, for the fourth quarter 2020, we expect the PDL ratio to be 1.6%, double what we have on September. We are not expecting any better situation, just 1.6% for the fourth quarter of 2020, and for the second quarter of 2021, we expect 2.2% PDL ratio. So, the effect of the crisis and asset quality is going to deteriorate from then on. So you will see that we are taking a more holistic approach to this forecast, and we have been reviewing daily and weekly our transition matrices within the retail portfolio, and also, we are reviewing on a case-by-case basis the wholesale loan portfolio. So, Ernesto, I don't know if that's enough or you want to follow on, on your first question.

Ernesto Gabilondo
Yes. No, I think it's helpful to understand the level of the NPL ratio for next year, but I would like to know what would be your expectations for the remaining portfolio that will be resuming payments during October and November because the first wave was with a delay of only 9% of your total loans, and now I would like to understand if it's a riskier portfolio and if the delays could be higher than the previous one?

Gerardo Salazar Viezca
Yes. I will tell you that we are expecting more risk, obviously, because unemployment numbers, GDP numbers are rebounding, but not to take the previous level of the COVID crisis that we're seeing. If you would like to get into details, we can share on a one-on-one basis our transition matrices with conditionals and marginal default probabilities and also our vintage analysis, if you would like. You will see that our transition matrices are well-behaved and are expecting some monotonicity requirements, but all in all, reality-based, you will see, for example, 3 things: the worst rating classes present higher default probabilities; second, transition probability decreased with increasing the number of notches from the initial rating class; and third, probability of migrating towards certain ratings higher for the newest classes. So, we are closing that assessment on a biweekly basis, and we publish results and report results to our CEO on a monthly basis. So, we are following this development very closely, and we were doing the same thing in our wholesale loan portfolio, those of commercial and also corporate loans.

Rafael Victorio Arana de la Garza
And Ernesto, just to complement what Gerardo mentioned. Remember that we rank the -- on high risk, low risk, a medium risk and no risk, and what we have been seeing is that there's, as Gerardo mentioned, a lot of stability on this cluster. So, there is no migration to high risk and less migration to a better risk. So, it's quite stable. Better -- a lot better than expected, and even the new ones that the last -- the latest wave that we expected, that where we were expecting a highest risk, we still see a much better behavior than expected on that, and remember, we will update the market on a monthly basis of any substantial movement on this. We will not wait for the calls. If we see a substantial move in either way or on a better way or on a worst-case scenario. So, I think now, better-than-expected. We think November will come to reasonable news and a much clear view we we'll have at the beginning of December on this part, and not -- up to now, we can differentiate the 2 clusters very clearly because those that enrolled in the great deferral program are behaving worse than those that didn't enroll, but those that -- where we're seeing the forbearance program are not compliant with a higher default probability that we expected. That's all in all, I think the synthesis of what we're seeing.

Rene Gerardo Pimentel Ibarrola
Yes. Yes. Let me just give you on a very specific of exactly what Gerardo has mentioned, I think he gives a very clear picture of that. Credit card, if you look at the credit card NPL ratio that usually the bank is rolling at, 6% to 6.2%, that's the steady state of the credit card. Now you're looking at numbers of 3.1%. We expect those numbers to jump to 8.2% in the second quarter of '21, and then go back at the usual 5.8% in the third and fourth quarter of '21. Why? Because the charges will start to happen in the second month of the year of the '21. So I think we have enough room, enough buffers to accommodate the deterioration that is coming based upon all the contention rates that's happened during the relief programs and the excess reserves that we provide for the -- on the bank for the book.

Operator
Our next question will come from Thiago Batista with UBS. Please go ahead.

Thiago Batista
Yeah, guys. Thank you for the opportunity. I have two questions. The first one regarding the bank's capital position, the capital of the bank ended the third Q at 14% or close to that. If this is allowed by regulator, can Banorte announce a buyback or maturity payment in 2021, if this is approved by regulators? And how can we believe about the bank's capital position in this new normal? How is the level of capital that the bank probably will have in coming years? This is the first one, and the second is about the branch network. With clients becoming more digital, is it possible to see a material reduction in the banks -- in the branch, in the number of branches of Banorte in coming years?

Marcos Ramirez Miguel
Thank you, Thiago. I'm going to start with the branch network. We don't expect a material reduction in a few years. We expect a shuffle going to the right places and maybe with smaller branches. We still don't know, but no, it's not the idea. Mexico needs a lot to the branches yet, and we need to go through a lot of places. So, the idea is to move to good places and remain pretty the same, and then we'll ask Rafa to talk about the capital position.

Rafael Victorio Arana de la Garza
Yes. Thank you, Thiago. As you know, we have always been very clear to the market that our ideal position on the core Tier 1 is from 12% to 12.5%. As you know, when we are current, actually that number dropped to 11.4% and rebound again after 6 months to 12.2%. So, the number that we would like to have on a constant basis is from 12% to 12.5%. This range based upon is when we pay the dividend to the group or not. Right now, we are at a high number on this. We are building up the dividend for '20 and to be eventually moved to the group, but the number is 12% to 12.5%. That's the number.

Thiago Batista
Okay, very clear. Thanks for the answer.

Rafael Arana
Thank you.

Operator
Our next question will come from Jorge Kuri with Morgan Stanley.

Jorge Kuri
Hi. Good morning everyone. Two questions, please. The first one is on expenses. What's the outlook for expenses next year? It's probably not going to be a great year for the economy, given still the potential problems with COVID in the first half of the year. Is there any room for Banorte to have a more aggressive approach to expenses and end up maybe having lower expenses on a year-on-year basis next year? What would happen -- what would need to happen for us to see that? And the second is on fees, and I guess related to the potential weakness on the economy, how do you see fees developing in 2021? What are the things that are going to drag fees down? Or the other way around, which should see better performance, again, in the context of potentially, hopefully, a recovery, but not a strong economy? Thanks.

Marcos Ramirez Miguel
Thank you, Jorge. Talking about expenses, it's not so clear because we have the good expenses. We continue growing our lending book, technological ones, so they need projects,

but the idea is to -- I don't know, inflation maybe around that or something like that, and talking about the fees, Rafa, please help us.

Rafael Victorio Arana de la Garza
Yes. Concerning the -- what you mentioned, Jorge, it's relevant. I mean, when you look at a lack of connection with GDP contraction and the loan growth that we have been experiencing this year, it's really quite confusing, but what we have seen, and maybe Gabriel can build up on this is that we already start to seeing a rebound in some key elements of the economy, still way below that they used to be, but -- like in job creation, car sales, retail sales and also the rebound that the GDP had on the third quarter. I will not touch more on this, but -- because Gabriel can add a lot more, but this is -- puts you in a conflicting view about what's going to be the evolution when you see the next year, the potential loan growth and things like that. So, I think there will be some good revenues of growth on the consumer on the mortgage book and also on car sales. I think payroll loans will rebound; credit cards will be slower to rebound. I think we will have a reasonable growth on the deposit base on that part. I think corporate and commercial will behave not as this year, but a reasonable number around 5% to 6% on that part, and what Marcos mentioned about expenses, this also is a key element of this. I think that at this point in time, when you see what has been happening in the market and that the lack of usage that you have on fixed assets like buildings and things, that will -- we need to accelerate that reduction in the expense base. We need to change structurally the cost base because marginally will not do the job. So, we need really to go structurally on that. I think our reorganization, back offices and back-office operations, consolidation on that part. In order to be able, as Marcos mentioned, to reach inflation numbers on the cost base, if we don't do that, if we don't change structurally the cost base, the cost base will creep up slowly, but will continue to creep up because revenue growth will be better than this year, but not at the pace as we used to have in the past. So in order to keep our efficiency ratio in the numbers that we would like to have, we need to change structurally the cost base, and that's what we are working on, and we will -- on the first guidance of next year, we will give you the evolution of that structural reduction in the cost base.

Jorge Kuri
Thank you.

Gabriel Casillas Olvera
So, Jorge, this is Gabriel. Let me add a few things that you already know, just to support a couple of things that Rafael and Marcos mentioned. As you know, a lot of people are wondering why the Mexican economy is rebounding at a faster pace, given that fiscal support has been extremely limited. As you know, Mexico is a country mainly driven by the private sector. In contrast with Brazil, that you know pretty well as well that the government accounts for 30%, 3-0, of GDP. In Mexico it is half of that. So, Mexico, as you know, it's a private sector country, and let me summarize in 3 aspects. Number one, even before we hit by COVID on the health-related issue, exports declined 40% and imports 20% in April. However, once we were able to reopen in May, in which the traffic light system that Marcos mentioned, allowed manufacturing companies to operate and reconnect with the global supply chain, exports rebounded 75% in June. In fact, automotive production has almost recovered in full in September.

Number two, on the unemployment -- on the employment side, sorry, after having lost 555,000 jobs in the formal sector in April, there were some job losses in May, June and July, but in August, job creation begun, and it has continued in September, and even though we don't have October data, the President this morning -- in his morning press conference said that there was a creation of more than 100,000 jobs. So, we're still facing a net loss of 700,000 jobs, but job recovery is taking place. In fact, on the unemployment rate side, it increased from 3.3% in March to 5.4% in May, and we are now at 5.1% and going downwards, and we have not even reached the all-time high of 6.3% that we reached back in 2009. Now this also reflected, as Rafael was mentioning, in large repayment sales. That has recovered quite quickly from minus 23% in April, an annual rate, to nearly 0% right now, with supermarkets doing very well. Actually, they have done very well throughout the year, and even department stores that suffered a lot, they are doing well, and number three and last, the sectors that will take longer to recover such as tourism, we have seen a quicker than expected recovery here as well. On the airline passenger side, we have observed a monthly average of 6.5 million travelers in the past few years. With the pandemic, it came down to 0 in April and May, and now we are roundabout 4.1 million passengers in September.

Now in terms of hotel occupancy ratios, we usually have a monthly average of 55%. COVID throw it down to 0% in May, and it has rebounded to 14% in September, 1-4. So, it's still down, but quicker than expected. So, summing up, we recently revised the GDP growth forecast for this and next year, up to minus 9% for year 2020 and plus 4.1% for year 2021. We are on the optimistic side of the spectrum, but honestly, I think we're very realistic, and as Rafael mentioned, today's GDP number of the third quarter, I think, give us a lot of conviction despite the uncertainties we are definitely experiencing.

Jorge Kuri
Thanks Gabriel.

Operator
And our next question today will come from Jason Mollin with Scotia Bank.

Jason Mollin
Hi, thank you, Marcos, Rafa, Rene, Tomas and Gabriel. Thanks for the presentation. I have 2 questions. One, I guess, would be on the top-down picture. If you can provide an update on congressional proposals that aim to intervene in financial markets? We saw Monreal's proposal on bank fees in the past, that seemed to be somewhat you guys -- the banking association seemed to be able to negotiate reasonable terms there. Now we're hearing about proposals talking about capping interest rates. If you can provide your views and colors on how that may impact the banking business? And then specifically on your operations, second question, can you talk about the hedging strategies you mentioned that the bank is using to secure net interest margins or at least stabilize them at a higher level? It is interesting to see that the operations with derivatives doubled in your balance sheet year-on-year on both the asset and liability side. I guess if you net them out, it wouldn't be such a big difference, but if you can tell us how you're managing that, the cost associated with that?

Marcos Ramirez Miguel
Thank you, Jason. Talking about topic number one, about the congressional proposals, you know better than we do, it's there -- sometimes it's there, sometimes it's not, and the last one, we are analyzing it, but it seems that it's reasonable because it gives the power to Bank of Mexico and CNBV about all these that they already have. So we're -- as you -- looking carefully for that, but so far, we don't have any news, which we should take care, and -- but we don't have more news than you have. And the second one about the hedge positions. Yes, we are very active on that, and we will continue doing that, and I will ask Rafa to walk you through some details about that.

Rafael Victorio Arana de la Garza

Yes. Jason, I will -- I'm sure I will confuse some of you, but I will try to go slowly on line by line, and let's compare September '17 to September '20, about -- as I mentioned before, the fixed rate loan book was MXN 220 billion in September '17, now it's MXN 300 billion in September '20. The total coverage of the book that we had on '17 was 36%, now it's 36%, the same, that the coverage with cost for that was -- 17% was coverage with a cost -- additional cost, now it's only 2%, and the yield on the loan book at that point in time was 13.4%, now it's 13.7%. The total cost on the balance sheet by that hedging process that we had in '17 was 3.6%, now it's 2.5%. Why we achieved that because we are basically using the stickiness of the deposit based upon the regulators' approval on that on several buckets that we have, and in that way, we can hedge the portfolio in a much better way, and that has been reduced the cost substantially. I can give you what was the -- and based upon this, we have increased the margin on the balance sheet from 9.9% to 11.1%. Happy to go on one-on-one to you and provide you the -- all the necessary information, but what I can give to you is that based upon the stickiness of the deposits, the approval of the regulators, the reduction and -- on the hedging cost and keeping the coverage ratio that we used to have before, we have improved based upon the growth on the fixed rate portfolio, the yield on the balance sheet, I would say, in a substantial way, with a lot less cost than we used to have before, but happy to provide that information to you. We will send that back to you.

Jason Mollin
Thank you very much Rafael and thank you Marcos.

Gabriel Casillas Olvera
Actually, one thing -- this is Gabriel Casillas, I would like to add something real quick on the congressional initiatives that Jason was asking. Honestly, we have seen no surprises on the political side, if we judge it by what has been happening. I mean, we're in the second year of AMLO, and you can tell that we have been -- as we have telling you that he has sticked to the policies he outlined in his books, including fiscal austerity, even with what we are experiencing in the pandemic. So, I mean -- and the other important thing is, I mean, zero of the nonmarket friendly legislative initiatives have been approved. So, no political surprises, and honestly, these [unintelligible] the fees and all that, are not in AMLO's book. So, as long as they are not there, we think that none of those prosper. So, I just wanted to highlight that, Jason.

Jason Mollin
Thank you, Gabriel.

Operator
And our next question will come from Tito Labarta with Goldman Sachs. Please go ahead.

Daer Labarta
Hi, good morning and thank you for the call. A couple of questions also. One follow-up in terms of your provisioning and thinking, excluding any additional provisions you may need, right? I mean, if you look at the cost of risk this quarter, it's down to 1.6%, pretty low level. So, just to understand, what drove it being so much lower? I mean, I know asset quality has improved. Is this sustainable? Do you think on a recurring basis, that cost of risk gets back above the 2%? How quickly would you get there without any additional provisions. Just to kind of think about the loan book now and the recurring level of the cost of risk, and then the second question on the back of that. In terms of profitability, you already reached a 17% ROE, perhaps the cost of risk may be a bit low at these levels. So, what's the sustainable level of profitability going forward? And can you get back to the 18% to 20% that we saw in the past? And if you can, what would be the drivers to get there? Thank you.

Marcos Ramirez Miguel
Thank you, Tito. Let me start with the first one. Carlos Gonzalez is going to help us with that.

Carlos Gonzalez
Sure, Marcos. Hello, Tito. I would say to you that eventually, cost of risk is going to get higher, and as of the close of 2020, we expect cost of risk to go as high as 2.2%. So, we are seeing the lowest level there is for cost of risk, and that metric could go up all the way to 4.1% at the middle of next year. So, let's keep that in mind because we are being consistent in forecasting the PDL ratio, the cost of risk and also, you should see a decrease in the coverage ratio as well. So that's the short answer for your question. I didn't you if want to follow-on on that. Or do you want more detail on that.

Daer Labarta
Yes -- no, I think that's clear. I think maybe addressing then the second question in terms of the profitability and what would drive that, particularly if the cost of risk was to go up.

Unidentified Speaker
And Tito, the second one is a tough one. We're working on that. It's a work in progress, but it's only an idea. It's not a matter of rate, it's a matter of spread. The rates were -- 5 years ago were, I don't know, 8, 9, I don't remember, and so the ROE was 20. Now that rates have fallen, they will continue going down. So, it's a matter of spreads also. Obviously, it's a matter of cost of risk, we know that, but we are working on that, that should be a nice one. Talking about 17, 18, for us looks very nice. I don't know for you, but we are working on that, and as soon as we launch the next program for the next year, we can discuss that. Thank you, Tito.

Tito Labarta
Okay, thank you.

Operator
And our next question will come from Marcelo Telles with Credit Suisse.

Marcelo Telles
Hi, hello Marcos, Rafael and Gabriel, hello everyone and thanks for the time. First, I have 2 comments here. I just want to thank for the disclosure on the LCR. I think aside from the fact that it's been improving quite a lot over the past quarters, the disclosure of the use of the credit lines are very useful, and clearly, you're in a very good spot on that. So, I appreciate that, and also the initiative on ESG and reporting on their size, the decision to incorporate size. I think that's very important for you guys in the long run. So, I appreciate that as well. My -- some of my questions have been answered, but my one -- I had 2 questions. One, if you can comment a little bit on what has been the performance of credit spreads as a margin on the large corporate and your government loan book? So, it'd be good to understand how that is behaving lately, and secondly, if you think about your [technical difficulties]

Operator
Pardon me. This is the operator. Just one moment.

Unidentified Speaker
Please proceed.

Marcos Ramirez Miguel

Gerardo, please go ahead.

Unidentified Speaker
Okay. Thank you. Marcelo, could you go back to the second one because we lost you in a bit. I think that the first one about the LCR and the liquidity and ESG, yes, I think we will be much more precise on that communication. Thank you for your comments and the feedback that you gave us to us last call. So, the second one was exactly what?

Marcelo Telles
Yes. So, my first question was on the relation of credit spreads on your government loan book and large corporate loan book, and my second question was with regards to the outlook for your NII growth going forward. I mean, if you think in 2021, if you think you'd be able to grow -- without, of course, committing to any number, but if you think it's possible to grow the NII next year?

Rafael Victorio Arana de la Garza
Yes. The -- I think the key element is a matter of what Marcos mentioned to us about spreads. Competition on the mortgage book has been, I would say, tough with some of the markets. So, we will continue to grow that book with some reduction of the spreads, but we still see room for the cost of funds to go down. So that's why we are modeling that our ongoing net interest margin for the bank should be around 5.5% or 5.6%. I think that could be a recurrent for '21 also, based upon the better spreads that we're getting, better cost of funds. If you look at our funding side, now the mix is 70-30. It was to go -- it went down as low as 58 to 42. So now we are at 70 to 30. So, we continue to push the cost of funds down. I think we have been quite efficient in doing that. So that will -- again, the growth in the fixed rate portfolio and the behavior of the portfolio itself will allow us to have a reasonable 5.5% net interest margin, may be on tops to 5.6%, but I think 4.5% -- 5.5% is a reasonable number to achieve.

Marcelo Telles
Thank you very much.

Rafael Victorio Arana de la Garza
Thank you, Marcelo.

Operator
Once again, if you would like to ask a question, please press star (*), then one (1). Again, it is star (*), then one (1) to ask a question.

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

Carlos Gomez
Hello, good morning. Thank you for the questions and also thank you for the disclosure on the risky asset, exposure to U.S. dollars, all of that information is very useful, and you presented very clearly, and I think we all appreciate that. I want to go back to the provisions, and we understand that this is a choice that you make and that the portfolio has been performing better than you expected and you don't need to make so many provisions, and yet, we're in the middle of the pandemic, there's uncertainty. Wouldn't -- if you have a lot of capital, wouldn't it be prudent to have a bigger reserve buffer? I mean, we know that your coverage is very high, but that's because the NPAs have come down. Wouldn't you rather accumulate a bit more provisions this year, just in case of what happens next year? Because otherwise, the impression we get is that, yes, you are maximizing the returns today, but in a sense, you're taking a bit

more risk than you might otherwise, and again, we understand this is a choice, and there's nothing wrong with having dollar provisions. The second question is about the dividend. It's very clear to us that you are ready to prepare the 2019 dividend if and when allowed. From what it seems there will be an event for next year. Do you feel realistically that you might also be able to pay a dividend on 2020 earnings? And in that case, we would have effectively something like a 100% payout ratio or we might skip 1 year because of the crisis.

Marcos Ramirez Miguel
Carlos, I will start with the second one. Yes, I don't know what they were, but we pumped already the dividend and it's ready to be paid, and we are only waiting for the -- it's a global issue. It's not a Mexican issue. So, we are waiting for the authorization, and it's going to be, we hope, in the next year, and yes, that's the 2019 dividend. So -- we are working for the 2020 dividend. It's going to be there also. We expect that as we see the numbers. So far, we don't see any problem, and going to the number one, the provisions, it is the same. We don't have more visibility, but with all the things that we can see and forecast and the pipeline and all these, we think that right now we don't need more provisions. I don't know if Rafa can give us more color on that, please.

Rafael Victorio Arana de la Garza
I think Gerardo will give you -- I think the key element for that is, as Gerardo just mentioned, the very key numbers, cost of risk, NPL formation through '21 and what has been our expectations, but I will just give you one thing. Do Banorte has room for additional provisions? Yes, we have a lot, if needed, a lot of room to provide for that. At this point in time, we don't see that need. Please Gerardo?

Rene Gerardo Pimentel Ibarrola
Sure, Marcos, Rafa. I will add just a review of the main metrics regarding provisions. The past due loan ratio, as you know, closed at 0.8%, is expected to close this year, third quarter, 1.6%. By the middle of next year, should be 2.2%, but the cost of risk, you've just seen it at 1.6%, is expected to close the third quarter of 2020 at 2.2%, and by the middle of next year, it should go up as high as 4.1%. At this point, Carlos, I will remind you that the extraordinary general provisions that we made at the close of June of this year of MXN 3 billion has not been being used yet, but we expect to use a big portion of that for the fourth quarter of this year. We don't just know how much of that, but we are prepared with that buffer. So, there are some buffers, and for the forecast point of view, I would tell you that our central scenario is currently what we have been using. We have been using as a tool for making the provisions, but we have on a [unintelligible] scenario and also a black swan catastrophic scenario and in which we can share with you that our capital, our solvency gets respected and solve the problem in a very good way and a very big, big way. So buffer, we have. Solvency, we'll respond. Yes.

Carlos Gomez-Lopez
And again, it's clear that you have the solvency to do more. You have said several times that the peak cost of risk will be 4.1%. What will be the average cost of risk for the year?

Rafael Victorio Arana de la Garza
No. I think if you look at the average cost of risk for Banorte on a running rate basis, that's around -- from 2.2%, it has shown in some cases to 2.4% in the past years, but I think the usual number is around 2.0% to 2.2%. The numbers that Gerardo has given you are not small numbers. The 4.1% is a big number compared to that, but it will immediately go down again to the normal levels because you start getting all the charge-offs and that -- on that part. So, I think that's the key element. Some people say, why don't you build more provisions?

Remember what Gerardo just mentioned to you, there was also a cleanup of the balance sheet of MXN 4.8 billion on the second quarter on the charge-off. So that's in addition to the MXN 4.6 billion of that -- on the provision line. If we need to do more, we will have much more clarity around December. An easy way to do things is let's put more provisions on the book and let's see what's going on, but I think that for us is not the best way to do things. I think we have to look at models, look at the behavior on a day-to-day basis. If we see a substantial movement on any of the viable that we are monitoring, immediately we will advise the market that we see some changes in the behavior that will push us to do more provisions, but at this point in time, the behaviors that we have seen is better than expected, and so we don't see a need to create more provisions. If there's room on the balance sheet and rooms on the income statement to do so on a capital basis, there's a lot of room. What Gerardo just mentioned about the black swan is really not a – it is very, very catastrophic provisions that we'll need to create additional -- usually, the bank goes for around MXN 18.4 billion on a usual year on provisions. That will mean to jump to MXN 40 billion of provisions on the catastrophic, but can we accommodate that without even touching the dividend that we have at the group level on that? Yes, we can accommodate that.

Carlos Gomez
Thank you, and again, for next year, you would consider it to be a normal year? I mean, something like 2.2% is what you would expect for the year as a whole? Or is a bit worse than normal year?

Rafael Victorio Arana de la Garza
Yes. Yes, the 2.2%, 2.4%, I think, is what you should be expecting, Carlos.

Carlos Gomez
Okay, thank you very much, very clear. Thank you.

Rafael Victorio Arana de la Garza
Thank you, Carlos.

Operator
And the next question will come from Nicolas Riva with Bank of America.

Nicolas Riva
Thank you very much for the chance to ask questions. I have 2 questions. The first one on asset quality. I wanted to ask you if you are -- about the accounting treatment of NPLs, if you're still counting all of the restructured loans that 18% of the loan portfolio as performing? And specifically, what's the treatment of that 9% of those loans that exited the relief program but are still not paying? And then it seems from the tone of this call and also from what we saw in terms of provisions for loan losses in the third quarter that you feel more comfortable with the economy in general. You didn't book additional loan loss provisions in this third quarter compared to the second quarter. So therefore, in addition to the current treatment, I also wanted to ask you when we should expect NPLs to be treated as they were before the pandemic? And then the second question on your perpetual bonds that you have a bunch outstanding. I wanted to ask you the -- you can call this bond starting in 2022, and I wanted to ask you what's your commitment to call these bonds. If I look at all of the Basel III bonds, the [unintelligible] but the perps do not, and if I look at the recent spread on the perps, this is about 500 basis points on average, but first, U.S. treasury yields are much lower than they were when you issued the perp. So I wanted to get your thoughts in terms of how we should think about the likelihood of these perpetual bonds being called? Thank you.

Marcos Ramirez Miguel
Thank you, Nicolas. I will start for the second one. Yes, we have a full commitment to call this -- these bonds regardless of the rates, and if we can do business because the rate is going up or down, the idea is to honor that and to continue with this in the next year. So that's the idea and a very strong commitment, and talking about the asset quality, I will ask Gerardo to discuss about that.

Rene Gerardo Pimentel Ibarrola
Sure. Sure, Marcos. Thank you. I will tell you, Nicolas, what we -- the treatment that we are being delivering as a solution for our customers on restructured loans is extending the credit term. We are giving them more ample room to comply with the obligations of the loan. Also, we are lowering monthly payments on a case-by-case basis, and we're making a diagnosis of the [unintelligible] and the credit risk profile of each and every one of the customers, and also, in some cases, we are providing charge-offs, which is something that we want to review very carefully because we don't want to cover that loan with a structure that makes it look like a good loan. That on the short-term is going to be bad for us and bad for the balance sheet and the income statement. So, we are providing those types of solutions in a case by case basis, but it is also different on the type of the loans that we are restructuring. There is no treatment for mortgages or bullet payments for revolving credit lines for credit card and auto loans. So we have a very interesting internal metrics in which we provide a strip for each of the account executives of the branches and also a strip for [unintelligible] so, what we were seeing is case-by-case treatment on restructured loans. So, we are trying to maximize recovery, and we are trying to put a solution on the table on behalf of our customers.

Rafael Victorio Arana de la Garza
Yes, and I would say, Nicolas because I think it's quite important what you mentioned about the Q1 and Marcos just mentioned. We have listened over the calls; I think there were some concerns about that if we will be repaying the interest because of this restriction on the dividend. No, the AT1s will continued to be paid fully on that, and we will honor the calls, and it's quite important what Gerardo mentioned about this. This 9%, some of those, we know they're never going to be able to bounce back into because they lost jobs, so maybe an SME, and we immediately do the charge-offs on that. We are not doubling up the balance sheet on that part, but the solutions come, as Gerardo mentioned, on a client-by-client basis, and we know one important thing. Banorte has been, for the last 20 years, the best recovery unit in the market by far. As you know, we buy and sell portfolio.

So we have been, I would say, toughened through the years by the cycles on this recovery unit, and this recovery unit is fully operational, talking to our clients, anticipating issues in order to be quite in line what the situation is. So we are not in a way a risk in any way. I think we are, as everybody, very vigilant about what's going on, but I think we are putting all the elements that we can in order to bypass this process, and the most important thing, the balance sheet of Banorte can withstand a lot of things.

Nicolas Riva
Thank you very much for that, Rafa, one quick just follow-up. The 9% of the clients that are -- that exited the relief programs but are not paying yet. Are you including those in that -- in the 0.8% NPL ratio? Or you -- or will you include those in the third -- in the fourth quarter? Hello?

Operator
Pardon me. This is the conference operator. Just one moment.

Marcos Ramirez Miguel
All right, it seems that we're out again. Could you please hold on a couple of seconds?

Operator
Pardon me.

Rafael Victorio Arana de la Garza
Nicolas, we include those.

Nicolas Alejandro Riva
Okay, you include those in the NPL ratio. Okay. Thanks very much, Rafa.

Rafael Victorio Arana de la Garza
Thank you, Nicolas.

Operator
And our next question will come from Geoffrey Elliott with Autonomous. Please go ahead.

Geoffrey Elliott
Hello, thank you very much for taking the question. I just want to check; I've got the message right on provisions because there were quite a lot of questions and quite a lot of answers. So, if I paraphrase what I think you were trying to say and then you tell us if I'm getting it wrong. So, for 2021, you're saying base case is cost of risk kind of 2.2% to 2.4%. If it turns out that things don't work out as well as you thought maybe with some of the loans on deferral or the way the economy is emerging from COVID, then you could kind of have a temporary spike to that kind of 4%, 4.1% level that you were talking about for, I don't know, a quarter. Is that what you were trying to say in all those questions on provisions and cost of risk?

Rafael Victorio Arana de la Garza
Yes, exactly right.

Geoffrey Elliott
Got it, thanks -- thanks for clarifying. I won't go with any more questions because I know it is being quite long already, thank you.

Marcos Ramirez Miguel
Thank you

Rafael Victorio Arana de la Garza
Thank you

Operator
And our next question will come from Yuri Fernandes with JPMorgan. Please go ahead.

Yuri Fernandes
Hi Marcos, Rafa, thank you. I'll try to be brief, too. Two questions. First one, the 9% of nonpayment in the deferrals, that includes the, I don't know, a second wave of deferrals? Because one of your peers, he has the NPL and also a small amount of the second wave renegotiations. So just checking if that number has the second wave? And if not, if you can provide us the number of like the second kind of reliefs you are providing to those customers?

And a second question here on this angle is discussions on provisions. From the previous conference call in the second Q, I had an understanding that the MXN 4.9 billion you did in additional provisions, that should be enough until the second half of 2021 to keep cost of risk somewhat stable around those 2%, and now I think I got a different message, right? So you're not calling this an additional provision, but 4.1% cost of risk is very similar to the level of cost of risk that you had in the second Q 2020. So just checking if the speech has changed here regarding provisions for 2021. Thank you.

Marcos Ramirez Miguel
Rafa – but -- yes, Yuri, the first one, the 9% includes our second wave of deferral. So far, so good. So that's it, and talking on the second one, the provision, Rafa?

Rafael Victorio Arana de la Garza
Yes. You have to look at the average cost of risk for the year. I think the numbers that we are giving you, the 2.4%, it's concerning that it will drop to 4.1% to go down to the 2.2% by the end of the year. So that's the difference that you see.

Yuri Fernandes
So, we should see some quarters with 1.8%, 2%, and the peaking with 4%, right? So some quarters should be below 2%?

Rafael Victorio Arana de la Garza
Exactly right.

Yuri Fernandes
Thank you.

And our next question will come from Natalia Zamora with GBM.

Natalia Zamora Madrazo
Hi, thank you for taking my question. Actually, it's a follow-up on charges. I saw that from last quarter's bad due loans to this quarter's, there were MXN 4.1 billion in charges. When looking at the consumers' nonperforming loans balance, we saw a relevant sequential decline, which I presume stems from the combination of support programs and the write-offs, but my question is, I was wondering if you could elaborate a little more on the write-offs and perhaps share some insight on what you expect in terms of write-offs in the coming quarters. I understand you expect them to increase, but do you expect them to be much higher on a quarterly basis than what we saw this quarter? Thank you.

Marcos Ramirez Miguel
No. Natalia, I think you need to remember that the charge-offs that we did on the second quarter was close to MXN 4.8 billion. The usual charge-offs that the bank does on a quarterly basis are MXN 4.2 billion, MXN 4.4 billion. If you look at the charge-off for the quarter on the second quarter, it jumped to MXN 8.2 billion. So that shows you exactly the size of the cleanup of the balance sheet and remember that we reduced the charge-off period for the SMEs from 19 months to 10 months. So that's part of the cleanup on that. So, that's also a part that we had, as Gerardo mentioned, that buffer on the balance sheet to absorb additional losses and has to do with also what Yuri mentioned. So, what you need to see is that the charge-offs will continue to be on the ratio of what we have been having in the past to the 4.4%, 4.2% on a natural basis. Maybe on the third quarter -- on the second quarter of '21, when you accelerate the charge-off of the credit cards to drop the NPL from 8.2% to the 6%, that will be the case.

Natalia Zamora Madrazo
Okay. Great. So, in the coming quarters, we could see something more in the line of what we saw in the second quarter or even higher?

Marcos Ramirez Miguel
In the -- no, I think, more in line for the first quarter.

Natalia Zamora
Okay, okay great. Thank you, very helpful.

Operator
Now, this will complete the question...

Unidentified speaker
Thank you, we have some questions that we received online. So, I will read them. I think the question that was made by Victor Galeno has been already answered. The same by Chris of Black Rock, I think Marcos and Rafael already answered when are we expecting to resume the dividend, and the third one is from Claudia Benavente from Santander. She's asking about the pension reform, any updates there? And she was expecting it to happen in September, and how is Banorte going to be affected by this? Are we seeing any M&A activity opportunity and consolidation in the market?

Marcos Ramirez Miguel
Thank you, Claudia. The pension reform is -- Fernando Solís, are you there? Go ahead, please.

Fernando Solís Soberon
Yes, I am here, Marcos. Do you want me to go ahead?

Jose Marcos Ramirez Miguel
The pension reforms, what do you expect or how do you see all that?

Fernando Solís Soberon
Well, as you know, it's in congress and we're expecting it to be passed, but we are not certain about the time in which it will happen, and of course, as you know, we have some features that will enhance the asset accumulation because the contributions will rise from 6.5% to 15%. That's very good, and we will have to see what's going to happen in terms of the -- there's an article about commissions, but we don't know yet, whether it's going to be standing royalty so it will be changed because there has been some lobbying about it, but if it remains the way it is, we will expect further consolidation in the system which, of course, is being our [unintelligible] largest of the system and we will benefit from that. [unintelligible] benefit from more asset accumulation and we will benefit from the consolidation, even though we may see some reductions in short term earnings, but that's ultimately we have to wait and see how it's followed. So, we don't know yet whether that article will be changed or not, which is article 47, which is the one that is concerning the [unintelligible] the most and which I think most players are very concerned about it. So we will have to wait and see, and we will also provide more accumulation if it goes through, and it will also benefit the pension part of the -- withdrawal part of the -- the accumulation phase, let us put it that way. The accumulation phase will be benefited [unintelligible] but also the annuity firms will be benefited because the -- because of 2 things. One is that more people will start to retire due to old age, given the transition of the law,

and therefore, we will have more assets there and therefore, more annuities, I mean more higher -- let's put it this way, higher annuity than otherwise. So, I think that will be beneficial also for the accumulation phase, but we don't know whether it's going to be passed this year or not, that's uncertain. I don't know if you want me to elaborate more on this issue or that's all right.

Marcos Ramirez Miguel
Claudia, talking about the second, the consolidation of the market, I don't want to sound boring, but this is always the same answer. It's our duty to see what's going on in the market. Yes, we see a lot of movement, let's see what happens, and then we will go to the first instance, the caps on the Board of Directors and then if it makes sense, we will go to the assembly -- at the assembly, it's up to you to decide whether it is going to happen, but yes, worldwide and in Mexico, we see -- we can guess that there's going to be a lot of movement, and yes, we are very strong and we can do some things, and we don't know, but let's keep it open and -- eyes open and see what's going on in the market. The opportunities will be there, and if it matches someone with our future, welcome, and that is always the same story, but it's always true. Thank you, Claudia.

CONCLUSION

Tomas Lozano
Thank you, everyone. With this, we conclude our presentation. Thank you very much.

Operator
Ladies and gentlemen, the conference has now concluded. Thank you for attending today's presentation, and at this time, you may now disconnect your lines.