Transcript of DBS fourth-quarter 2017 results conference call for buy and sell sides, 8 February 2018

Michael Sia Hello everybody and welcome to the fourth-quarter briefing for the buy and sell sides. We went through the media briefing just now and we can go straight into Q&A.

Nick Lord (Morgan Stanley) Good set of results, and I totally agree with what you've done on the dividends. I think it's a very good move.

In terms of costs, you said that it was ANZ that would lead to a stable cost-income ratio [in 2018 instead of] a falling one. But you must have known about that before. I'm just wondering why the change in guidance for the cost-income ratio, and should we think about this as a one-year pause? Or that the cost of investing in digital, to keep ahead of the game, which presumably is constantly changing, is such that the [decline in] cost-income ratio will take longer than we originally thought? How should we be thinking about that?

Piyush Gupta It's a one-year pause. The cost-income ratio in our budget for 2018 is at 42.5% ex-ANZ. With ANZ it will be back up to 43%. I'm fairly confident we'll keep seeing a half-percentage-point improvement in the cost-income ratio every year in the underlying business – while the ANZ businesses are being integrated.

[It] is also partly [due to] regulatory reasons. We had to bring in 100% of ANZ staff [and branches] in Taiwan and Indonesia. [Whereas] in Singapore and Hong Kong, we could pick and choose. [As such,] it's going to take some time to whittle down the branches and reach the right number of staff [through natural attrition].

Nick Lord As you do that, could it be a bit more than 0.5% [points] in, say, 2019?

Piyush Gupta Hard to call because I'm also investing in technology at the same time. For example, we're making a big effort this year on data. We've done a lot of work on digital but data is one area where I think we need to do even more. We're making a massive effort to re-architect all our data. We're [almost complete with a project on] big data. We have huge new data architectures. These are incremental items which, frankly, I had not factored in [earlier]. As some of these new technology investments come in, [around] 0.5% [points] a year is what we're looking at.

Aakash Rawat (UBS) A related question to this: when I look at profitability for the consumer segment in the last three to four years, as you described it, it has become much more profitable today. ROA has gone from 100 to 200 basis points, almost a 100-basis-point improvement, which is much more than what we've seen from peers. One part of it would be rate leverage; the other one would be your cost efficiency through digitalisation; the third could be some internal allocation. How would you attribute each of the different factors that have driven this?

Piyush Gupta [It's the first two –] there has been no internal allocation change. [I'll first comment on our] efficiency. In 2010, one of the four things we [decided on] was that there is a lot of [profitability] in Singapore we are leaving on the table. Our market shares were eroding and our cost-income ratio was too high. We started addressing that, to rationalise distribution, improve market shares and [figure out how to] do more with the same [or less resources] – and you get the lift.

The digital transformation also really shows up over there. The data we showed [during our investor day] is so compelling, we've now done it over three years, [in showing that when] you move a customer [from non-digital] to digital the [income] from the same customer [doubles]. I don't have [significant] incremental cost – [these digital customers] do more transactions so I have [some] incremental cost – and the cost-income ratio of the [digital segment] just [improves] massively.

The digital part of that business is giving me a 27% ROE compared to 19% for [non-digital]. Last year, we shifted 250,000 customers into digital. Our goal is to try and shift another 250,000 this year. Every time you move customers over to [digital] you get the ROA and ROE lift.

Aakash Rawat This should continue then – not something that will be stopping here?

Piyush Gupta This should continue at least for the next two to three years, then you run out of customers to convert. But [there are] other things. It's not just conversion. The other interesting thing – apart from an immediate lift when [customers] convert – is a [rapid] deepening [of engagement]. We also track how much lift a digital customer converted [in a previous] year who stays digital versus a [non-digital] customer – it is [very much higher] on the digital customer side. [Even after we] migrate [all the customers we can to digital], you will still get a lot of deepening impact even after two or three years.

Aakash Rawat Does this change, in any way, your guidance on branch [numbers] in the future?

Piyush Gupta I'm not sure we ever gave any guidance [on branch numbers]. We will continue to think about [our] distribution footprint. As you know, in Europe – Scandinavia and Netherlands – banks are down to one-third of their branch footprint. We don't anticipate getting to one-third of our branch footprint any time soon, but we're reducing our branches. More importantly, we're restructuring the branches. Take our Plaza Singapura branch for example, we use fewer people, more technology, smaller floor space and therefore lower footprint. [It becomes] a much lower-cost branch overall. That we're continuing to do. We'll see a substantial impact of that. We saw that last year. We'll see that this year. You'll see that through to 2019-2020.

Aakash Rawat Just a follow up question on asset quality. I think we're pretty okay in Singapore for now but, given the new US rate outlook, rates are probably going rise like three or four times [this year], like you said. Are you getting a bit more worried about Hong Kong, especially where leverage is very high, and which are very rate sensitive?

Piyush Gupta No. Our Hong Kong book is [at the] top of the market. We don't have a large consumer book. [On the property side,] we started shrinking the mortgage book five years ago. We have an unsecured book but delinquencies are looking okay. Most of our SME book is heavily secured with a lot of shop houses. I expect some delinquency will creep up, but relative to some of the pain we've taken in the last two years, it won't be material.

Melissa Kuang (Goldman Sachs) On margins, you guided for them to increase, mainly from rate hikes. What about your securities book? I see on the slide that you have moved into slightly longer duration? Is there an intention this year to push it a bit further?

Piyush Gupta It depends on our view on rates. At the right time, if you think the yield curve is at the right place, yes, you would increase duration. But, you don't want to do it ahead of time because, then, obviously, you give up value as the yield curve rises. One of the things that allows you to do more of this is a new FRS 109 rule. Sok Hui, could you explain?

Chng Sok Hui Yes, it's in the performance summary. Effective 1 January 2018, in addition to the change for Expected Credit Loss, the standard also requires banks to reclassify their portfolio. We moved about $16 billion of our available-for-sale portfolio to held-to-collect. In the past, the equivalent was held-to-maturity which had a tainting provision. Once it is tainted, everything has to move – as such we put very little into held-to-maturity [in the past]. Because of the new rules, we're [now] able to put more [of] our liquid assets portfolio not intended for trading [into] held-to-collect. [This] reduces volatility and noise [due to] interest rate changes. [As such, there will be less fluctuation in] AFS reserves.

Harsh Modi (JPM) A couple of questions. One is on CET-1. You said [you were targeting] 13% plus minus 50 basis points. This dividend pay-out will get you to 13% with RWA increase coming up 5%. What is the minimum level beyond which you may have to re-think that growth? Because at 50% effective pay-out for the next couple of years, [what is] your ability to grow the book beyond 7-8% without burning capital? What is the minimum level [of capital] below which you may have to either re-think investment or growth?

Piyush Gupta 12.5%**.** And that's why I say we don't have a guided pay-out ratio. If I just kept $1.20 [dividends] constant, I would be able to afford extra asset growth.

Harsh Modi Right, but $1.20 is sacrosanct.

Piyush Gupta Nothing is sacrosanct. However, it is reasonable to assume that [the minimum] would be $1.20.

Harsh Modi Okay, the second is on dollar repatriation. Is it possible for you to quantify how much of your dollar deposits could potentially go out of the door if we have sustained repatriation? A lot of these tech guys have paid tons of tax already, and that money can go out tomorrow morning. From your ALM perspective, how are you thinking about it?

Piyush Gupta We have done this [exercise] twice now in the last six months. We talked to the corporate treasurers of all our big clients to try and get an assessment of who might move money out. The answer is always very vague. I did this twice – just to make sure.

A large part of that US$2-trillion-odd which is lying outside [of the US] is in London. My thinking is if [a significant amount of] money was moved out of London that would also squeeze Asia. I think some [of that] will happen, but not a lot. As I said before, we're keeping a lot of cash and for the last two to three quarters, we're keeping $4 billion to $5 billion in cash always – in case you have some sudden shock or volatility in the market.

I think that's probably enough. We [also] have this large $41 billion of financial asset holdings, so if needed we could always repo and get more liquid cash. In the funding markets, our ability to raise more, whether it's covered bonds, [medium-term notes] or [commercial papers], is quite strong. If you compare us with the Australian or Canadian banks, we're not a big borrower in the market. We could always borrow more in the market if needed. So, it's not a liquidity concern for me.

The bigger question is what would cause a one-way dollar outflow that wouldn't come back. Money is fungible. Just because you take money into the country doesn't mean you can't take money out of the country. What would people do with the money once it [is taken] in? It stays in the country only in two circumstances, either you choose to invest it in the country or you choose to buy back your shares and return it to shareholders. [Outside of those two cases] the money [will make] a round-trip and come back – you'll put money back to work wherever you get a good return. It won't happen immediately, you'll have spikes, but money will flow back.

Most of the clients we talk to are not really looking at making major investments in the US, so even if you have to [take money] back [to US] and pay lower taxes, you can either borrow against the cash or you bring the cash out again.

Harsh Modi Okay. Just to confirm, I'm not worried about a two-year view on that but if immediate repatriation happens – let's say it gets bunched up – would you have optimised your ALM to the extent that you will have no problem even if $5 billion goes out tomorrow morning?

Piyush Gupta First, we keep cash to cater for that. Second, we have a five-step [action plan] if liquidity [is squeezed]. So I keep cash ready – I don't want overnight [yield]. Second, I have a lot of the liquid assets which we can repo on the same day – [and] build cash against that $41 billion of liquid assets. Third, I have a $50 billion trade finance book. The trade finance book is short-term and keeps rolling, and that's discretionary. I can turn the tap on that whenever I want – I grew $10 billion in the last year. If I turn the tap off on that, I can [deal with substantial billion-dollar] outflows every month. While [the trade finance book] is revenue and return-accretive, it's not franchise damaging if I just turn the tap off that book.

Diksha Gera (Bloomberg) On mortgage profitability, 30% market share is awesome, but how do you see the competitive dynamic in that market shaping up?

Piyush Gupta First, start with remembering that from a risk-adjusted standpoint, it is just massively profitable because our total risk weight for mortgages is up to 7%, so if I have 60 basis points of net spread at 7%, that's just a fantastic return on risk-adjusted capital. I don't think profitability is a concern with that business at all. On top of that, the portfolio yields are holding and over the last couple of quarters we've been able to push pricing up. As we've pushed pricing up the market followed. Through-the-door is moving up, and the portfolio yields are holding up relatively well – they've come off a little bit from 1.90% [18 months ago] to about 1.80%-plus now.

Diksha Gera And, at what point do you start thinking about the asset quality?

Piyush Gupta I think because the bulk of our exposure is in Singapore, the question is when do you start seeing unemployment going up in Singapore? I don't see unemployment being a challenge in Singapore in the near term. The pick-up in rates is not that material. First, we use [an interest rate of] 3.5% when we calculate debt burden ratio. So, you already have a massive [buffer] in terms of the affordability of people when they buy the house. [On top of that,] the bulk of servicing comes from CPF, so that's never a problem.

Marcus Chua (Nomura) Just on that point, do you see the RWAs for mortgages increasing after the Basel 2017 recalculation?

Piyush Gupta We've had several discussions with our regulators. [There's a] 50-year track record of Singapore mortgages to build models on. Even in Europe, after the [finalisation of Basel rules], every large state was able to have a carve-out for mortgages.

Nick Lord On your guidance on risk-weighted assets. You said [there would be] a 5% increase [with the finalisation of Basel 4], and you said you were alright on the standardised floors. Is this 5% due to the Fundamental Review of the Trading Book?

Piyush Gupta No.

Chng Sok Hui There's a standardised approach for counterparty credit risk which kicks in 1 January 2019. Then there is the FRTB. And then there is the host of credit risk measures which, frankly, there isn't much impact. So, overall, it's just 5%.

Nick Lord So, we should expect the impact of that entire 5% to come in from 1 January next year?

Chng Sok Hui No. Standardised approach for counterparty credit risk is probably 2%, and then the other 3% you'll see in 2022.

Piyush Gupta We're $280-odd billion in RWA [now]. [You can] expect to see [an increase of] about $14 billion, of which about $6 billion will come in January 2019, and the balance $8 billion will come in January 2022.

Nick Lord And to what extent to you think by then you'll be able to minimise that? That's obviously a pro forma of where you are today. I presume there are things you could do to lower that, so to what extent do you think you'll be able to mitigate that by the time we get to 2019 or 2022?

Piyush Gupta There are other mitigations – [for example] some parts of our book are [still on the] standardised [approach] and we're working on getting those models approved [for them]. So we still have room to continue to optimise RWA efficiency.

Chng Sok Hui I think one of the consequences would be for the undrawn uncommitted facilities that you advise customers, today the Basel effect is 0% but going forward it's going to be 10%. [As such,] you probably wouldn't want to give lines in excess of what the customer really needs. At the same time, those [facilities that] are truly committed, the Basel has reduced the risk weight from 25% to 14%. So there's some offsetting impact.

Aakash Rawat Can you explain a bit more why the impact from the floors is minimal? When you look at the risk weighting, it puts your IRB risk weights at 72.5% of your SA, [that would translate into an] impact of $50 billion in RWA. What's the difference here?

Chng Sok Hui The difference is because a large part of our overall portfolio is not impacted by model change. There are basically two things that would impact you. Basically, if we think about the 72.5% floor, it's telling you that, overall, your models cannot give you efficiency of more than 27.5% at an aggregate level. So, mortgages will be one where there will be a differential with a 7% risk weight, while a standardised approach would probably land you closer to 30%, so there's a [difference]. For corporate risk weight, currently you're at about 50%, [a standard approach] will land you closer to 100%. These are factors that [have a negative impact on RWA]. But the rest of the portfolio, about 65% of it, remains that same. You have the benefit of the 72.5% risk weight under the standardised stack, which means the two offset each other.

Anand Swaminathan (BAML) So, you're seeing a positive impact from the 65% of the book?

Chng Sok Hui The rules cap [risk weights for the rest of the portfolio] at 72.5%, which reduce the impact you'll get from higher risk weights for mortgages and corporates. That's why overall there is no change. [This is also] partly because they're not advanced IRBs – advanced IRBs for banks, sovereigns and large corporates are no longer allowed under the new regime. That's where I guess most of the European banks have advanced models. Of course, they calculate their rules differently, and that's why the impact is a lot more severe for them.

Aakash Rawat How would you calculate the risk weights for mortgages? Wouldn't it go up as a result of IRB?

Chng Sok Hui No, it wouldn't go up. You calculate based on 7% – just the way you always calculate. Then, you calculate based on the standardised stack – that's a rule that every bank has to follow. For example, say my mortgages will be now 30% instead of 7%. My corporate risk weights will be 100% instead of 50%, so you stack everything up. Then, on the aggregate level [including the remaining 65% of the portfolio], you take 72.5%. When you compare the two [ie, the as-is internal model approach and 72.5% of the standardised approach], our number under the internal model approach would still be higher. So the floor doesn't hit us; that's what it means.

Robert Kong (Citi) I'm just thinking about how to model the credit cost for 2018. I think you've guided that GP might be 20 bps, rather than 1%?

Chng Sok Hui The 20 bps is only for stage one [ECL].

Piyush Gupta Stage one is about 18-20 bps. Stage two will come from portfolio migration. Portfolio migration, because I think the overall environment is benign and that we [have already] flushed out our [weak oil and gas support services] portfolio, should be low – but you never know. We'll start seeing rates going up. You'll see portfolio migration on the back of that. That will add to the 20 basis points.

Robert Kong For the fourth quarter where you took a normalised number and you said there were some bits and pieces in China and India. If I took those out, what would SP be? That would give a sense of what you might take in 2018.

Piyush Gupta I'm wondering how to hedge my bets!

We told you last quarter that ex-oil and gas, SP would be $112 million. If nothing goes really wrong, I don't expect it to be a lot more than that [per quarter]. The reason I want to hedge my bets is that I don't want to be held to that number if something goes wrong; for instance, if rates go up. That's why my budget is much higher than that. I keep that [budget number high] simply because there are uncertainties that can come – but I'm not seeing it.

Chng Sok Hui And going forward, any additional specific provision, if you have envisaged it should be in your stage two ECL number, you can transfer to stage three to offset the specific provision. You'll get that transparency with the new disclosures.

Robert Kong Just one add-on. Because you've been so conservative in the third quarter recognising [oil and gas exposures as NPLs] and you've already started to restructure some of those loans, is there a chance of some recovery?

Piyush Gupta I doubt so. I think that even though we're restructuring the loans, I'd wait a year just to make sure that the cycle is really behind us. You can see at the margin we had some $45 million of recoveries in the quarter, but nothing material or meaningful.

Anand Swaminathan A bit more of a top-down question. [Regarding the strategic priorities you set for DBS in early 2010], I think one could argue at this stage [that] almost all of them have been achieved or, at least, wheels have been set in motion, except the 60:20:20 that you mentioned.

Piyush Gupta Three out of the four big strategies we've achieved. [The] one [question left] is how do you grow in the growth markets?

[This is where we think the answer could be] digibank. We couldn't do it inorganically – that didn't work. We [also] found that an organic build-out was not working either; we're getting top line growth, but we're not getting scale. So, I'm trying to take a third stab at it, to do it digitally.

Anand Swaminathan Looking forward from now on, next two to five years, if you had put that agenda now, what would be your strategic priorities? Most of them have gone into an execution stage already.

Piyush Gupta Hold on. There's only one [change in] priority, which is how do you compete with Amazon and Alibaba and, frankly, if you don't get that right, it doesn't matter anymore. The rest of the priorities haven't changed. If you look at our corporate banking business, it's doing well, but there's a lot [more we can do]. We've grown cash management from $400 million to $1.1 billion in five years. At $1.1 billion it's still a fraction of what HSBC and Citi are in Asia. There's no reason why I should be less than half of what these guys are in cash management or on the rest of the corporate banking business. I think there's a lot more with China coming out and the digital transformation there.

I think the big story in the WTO extension to 2015 was China opening up on the trade account. I'm convinced in the next ten years, the big story will be China opening up on the capital account.

Aakash Rawat Just one housekeeping question on tax rate. This quarter was 15% and, historically, you've done 13-13.5%. Should that be the number that we should look at?

Chng Sok Hui If you look at the full year, it's still 13%. We took a $850 million GP [write-back in the third quarter] and the tax impact was effective this quarter. So, it's [resulted in a] higher tax rate.

Melissa Kuang In terms of China, you talked about growing the offshore book for China again. What kinds of opportunities and risks do you see there?

Piyush Gupta Well, all the usual lending risks. On top of that, there are also the HNA and Anbang kinds of risk. So, there are certain counterparties you've got to be thoughtful about. But the rest of it is just the normal credit risk. These Chinese companies are going into countries, they're going into targets, they're going into industries which sometimes they don't know. Oftentimes, the financing is predicated on the target. So, you've got to work through all the credit disciplines quite robustly.

Melissa Kuang These will be collateralised loans?

Piyush Gupta It depends on the nature of the deal. We do a lot of M&A financing, for example. A lot of times it is not based on the corporate balance sheet, but it is based on the target company balance sheet and financials, in which case you ringfence that and finance that. Sometimes you're doing regional treasury operations that we're financing on the corporate balance sheet. So, the structures vary, but by and large, they're collateralised.

Nick Lord You've got digibank rolling out in Indonesia. What other markets do you think are viable for a digibank strategy?

Piyush Gupta We're examining what we want to do with Hong Kong and China. So now that we've got our proposition we were able to do [digibank in Indonesia] at 40% of the cost [of digibank] in India because a large part of the cost was already sunk. The next country will be even cheaper.

The other country where there is a possibility we'll explore is Vietnam. We have a full licence there. It's maybe not a 2018 agenda, but we could look at that as an example.

Asheefa Sarangi (CLSA) A couple of quick questions. First, on ANZ, can I just confirm how much of the profit this year was from ANZ and whether we're on-track for the $200 million contribution around 2019? The second thing I wanted to follow up on was, for the cost-income ratio, with the pause this year at 43%, do we still anticipate that we'll be at 40% by 2020?

Piyush Gupta Asheefa, on the second question. My 40% guidance [then] was over the next five years or so – not a 2020 target. And, our subsequent guidance, I think we can get down about 0.5% [points] this year.

On the ANZ question, we got about $100 million in the top line and $34 million on the bottom line in 2017. For 2018, we'll be close to the $175 million to $200 million range [for the bottom line]. In 2019 we'll [be well above] the $200 million number.

Harsh Modi On your 43% cost-income guidance. If I take that ten-basis-point NIM pick-up, assuming 5-6% balance sheet loan growth or slightly higher, it gives me about 11% net interest income growth. If your trading normalises another 10-11%, and based on your 43% cost-income ratio guidance, costs would have to go up $750 million from a $6.8 billion base. Is that what you are looking at or is there a degree of conservatism in that 43%?

Piyush Gupta I haven't worked the numbers back, but I'm looking at a cost increase of high single digits in 2018 because I've held costs flat for the last two to three years and I'm going to be investing in some technology [projects].

Chng Sok Hui Remember also we have a full-year impact of ANZ. Last year, the impact was only in the second half.

Harsh Modi And that delta is about $100 million more?

Piyush Gupta More. [In 2017] the total expense from ANZ was $40 million, [in 2018] it will be around $340 million. There's $300 million of ANZ impact in there.

As I told you, I expect to get about $600 million [at the] top line and about $340 million-$350 million of expenses from ANZ this year.

Michael Sia Thank you all for coming or dialling in. We'll see you next quarter.