Edited transcript for DBS second-quarter 2019 results conference call for buy and sell sides, 29 July 2019

Michael Sia Welcome to our second-quarter session for the buy and sell sides.

Nick Lord (Morgan Stanley) The loan-loss charge is now below the through-cycle average. You have talked about the possibility of getting some recoveries going forward. Are you saying that for the next two or three years you can keep the loan-loss charge below the through-cycle average?

Piyush Gupta We've got three things happening here. First, we have been conservative in provisioning. We have built up some fairly strong buffers, including during this quarter, when we took additional general allowance charges through the management overlay because of the macroeconomic environment. Second, our past provisioning has also been conservative, particularly in the offshore marine sector. There are situations where, after restructuring, there could be recoveries. But, third, the important thing is that structurally, we made some meaningful improvements in our risk management capability. Our processes are a lot more robust than they were five years ago. So, in a structural way, our ability to manage allowances is better than it used to be.

Nick Lord Through-the-cycle specific allowances are at 25 basis points?

Piyush Gupta Twenty-five to twenty-seven basis points is the guidance we have given.

Harsh Modi (JP Morgan) Could you elaborate on some of those risk management changes? Are they more consumer linked? Or SME, corporate?

Piyush Gupta Mostly corporate. What we've done in the past two to three years is to tighten our corporate credit management. We have got a lot more diversified, we have far more robust early warning signals. We have actively managed and rebalanced our portfolios. For example, in the first half of the year, we sold down about $2 billion of loans. We anticipated, got ahead of the curve and reduced our exposure to some weaker exposures. We are a lot more active than we used to be.

Harsh Modi You let go about $3 billion of deposits in the quarter and raised $7 billion of commercial paper. How much more can you do?

Piyush Gupta We could do more. Our total CP borrowing is $23 billion. There could be additional market appetite. The fixed deposits we've let go were high cost and not from core customers.

In terms of asset yields, if rates come off, obviously pricing will come off a little bit. You could start seeing some drops in Hibor, Sibor and Sor. What's unclear is what happens to Hibor, which has been extraordinarily strong. However, there is still the tail-end of our fixed-rate loan book, which includes mortgages, that is still being re-priced.

Robert Kong (Citi) First, looking at the year-to-date breakdown of loans, you are doing much better than the system. What's driving the growth in "others" and in "professional and private individuals"?

Chng Sok Hui "Others" is mainly from Singapore's statutory boards. "Professionals and private individuals" is partly due to financing for a global income bond we launched in the first quarter.

Robert Kong On mortgages, where are you seeing a pick-up in? Because I'm assuming it's in primary transactions; secondary transactions are still pretty soft.

Piyush Gupta The resale market is soft but there has been some pick-up. Bookings for refinancing activity and primary launches also picked up relative to first quarter.

Robert Kong On NPLs, could you elaborate on the movement in South and South East Asia?

Piyush Gupta The big movement was a company that is government-backed. We have got strong support from the government. We took some allowances to be prudent but do not expect anything to go under.

Harsh Modi How much allowances did you take?

Chng Sok Hui About 20%. We received a letter of comfort from the government after the second quarter ended.

Piyush Gupta The total exposure of this entity in Indonesia is $2.5 billion. Our exposure is small, around $50 million. Other banks have not marked it as an NPL and have taken no allowances for it. Given the government support and the fact that it is being restructured on acceptable commercial terms, we need not have taken allowances for it either.

Robert Kong Can you talk about your stress tests? Hong Kong and China look risky, but you said there are no issues.

Piyush Gupta We have been proactive about addressing weaknesses for the past six to eight months. We tested the tech supply chain of 400-500 companies to see the impact of tariffs going up to 25-50%, and the RMB at eight to the US dollar instead of seven, to see which companies were likely to exhibit more stress. Then we looked at ring fencing and managing down exposures for those companies.

Melissa Kuang (Goldman Sachs) The Indonesian banks have cautioned that there could be problems with names that haven't been recognised as NPLs yet. Do you think that you would have some of the exposures?

Piyush Gupta We have had problems over the past two years which we have already recognised as NPL and provided for. At this point in time, I do not think we have anything else.

Melissa Kuang You mentioned that you've improved your corporate loan underwriting. Will that translate to lower RWA?

Piyush Gupta The Stage 1 and 2 ECL (or general allowances) over the past two quarters reflect a reduction in our exposure to weaker names.

Chng Sok Hui Under SFRS(I) 9, general allowances are increased for Stage 2 exposures before they become NPLs. When they do, the general allowances are transferred to specific allowances. So that's one reason why general allowances go down. The second reason for general allowances to decline, which we explained in the previous quarter, is that we have been managing out Stage 2 exposures before they become NPLs. The $58 million general allowance charge this quarter is net of the impact from both factors. We took a much higher number than $58 million for the management overlay buffer.

Melissa Kuang In terms of mortgages, what is the pricing difference between the back book and front book?

Piyush Gupta For the front book, we compete tactically. So far, we've been able to hold market share without resorting to significant price undercutting. Our overall portfolio NIM has been holding up. What happens going forward is harder to say. If people start cutting prices dramatically, then we would have to compete.

Aakash Rawat (UBS) First, what drove the decline in the RLAR this quarter? Second, is your better risk management being driven by the SFRS(I) 9 framework or something else?

Piyush Gupta Our risk management is not dependent on SFRS(I) 9. Rather, our ECL outcomes stem from our improved risk management process. The RLAR is a balancing item to compensate for any Stage 1 and 2 ECL (general allowance) shortfall from the MAS 1% requirement. Since general allowances increased this quarter, the RLAR came down.

Aakash Rawat Your wealth management income this quarter was strong, at almost the same level as first-quarter 2018, although there was a lot of market volatility. Was there any one-off this quarter?

Piyush Gupta The performance came from a variety of products. Unit trusts were up significantly, currency-linked products, insurance. There was good broad-based momentum.

Aakash Rawat Would you expect this to continue?

Piyush Gupta So far, it is looking good in July.

Aakash Rawat One of the virtual banks' key advantages is that they don't have branches, which will enable them to have a lower cost-income ratio. Will this make you rethink your branch strategy or your steady-state cost-to-income ratio target over time?

Piyush Gupta If you start from a clean slate, you can run a virtual bank much more cheaply. But you have to pay for customer acquisition. The amount of money spent acquiring customers could offset the cost of a branch infrastructure. Many start-ups are burning money to get hold of customers. We could theoretically reduce the number branches, but because we are the public bank in Singapore, there's a limit to how sharply we want to cut down on branch footprint. What we've done, and will continue to do, is to maximise the efficiency of our branch network. We have halved branch headcount and reduced branch size.

Diksha Gera (Bloomberg) You're obviously ahead in the digital journey and agenda. Do you think entrants could possibly generate new revenue streams? With strong parents backing them, could alternative things come into play and chip away at your market share?

Piyush Gupta It is possible. So far, I've not seen any evidence of revenue streams from digital banks anywhere in the world. Only Ant has a consistently strong revenue stream, which is not new. In China, they've tapped into a lending market and are funding people who do not have basic banking facilities. Moreover, there are no lending restrictions in China in that regard. In Singapore, MAS imposes unsecured lending restrictions to consumers, and it is a small market.

You might argue there are opportunities in micro financing, but I'm still looking for some good cases. Every banking revenue stream comes from raising money, moving it around more intelligently and charging fees along the way. Can I charge fees by being more efficient in the way I move money around or raise capital? It is not clear where the big opportunities to create revenues are.

Diksha Gera You were ahead in India but other banks appear to be catching up. Could you share some thoughts?

Piyush Gupta It is not just India. Every bank is investing to catch up. I think there are some challenges, which are not easy to overcome. One is changing your whole tech stack. We have had to retrofit the whole tech stack, moving to micro systems, moving to the way big tech operates. Second is changing the way you work. To drive a culture shift to compete with the big tech companies is not easy. There is certainly progress in the banking industry overall, but I think for banks – including us – when you compare us with how Amazon, Alibaba operate, we still have a long way to go.

Krishna Guha (Jefferies) Recently, there has been some green financing, reportedly at about 20 to 50 basis points lower. Is there margin profitability trade-off?

Piyush Gupta There is a trade-off. We're giving up some profits to drive this agenda. Fortunately, it's only a couple of basis points lower. I'm happy to promote the agenda but so far it necessitates a trade-off.

Krishna Guha It seems interesting that given your overall risk management culture, credit costs will come down. Do you think there is also room for the capital counter-cyclical buffers to be lower?

Chng Sok Hui There are Basel rules governing them. I don't think MAS will amend these buffers.

Conrad Werner (Macquarie) I just want to have a quick follow up on the outlook for the mortgage book. There was one comment in the media session about a net flat outcome for the full year. But later there was also mention of adding growth of $2 billion to the book year over year. Could you just repeat the official guidance on the mortgage outlook?

Piyush Gupta The $2 billion refers to the delta between the first half and the second half. The first half was minus $1 billion, and we expect the second half to be plus $1 billion, with the full year at between flat and growth of $0.5 billion.

Robert Kong Just thinking about extreme situations. What metrics do you use before the 30-cent quarterly dividend gets reduced?

Chng Sok Hui We have guided for a CET-1 operating range of 12.5% to 13.5%.

Piyush Gupta Right now our bias is to increase, not reduce, dividends. So, you and I are in completely different parts of the universe, Robert. If you go back to our recovery plan, it essentially says that if we break through our capital targets, then we might rethink our dividend. But even before we get to that situation, we would have used other tools such as letting go of inefficient assets to reduce RWA. Moreover, we give careful consideration whenever we raise the dividend because I do not envisage ever having to cut it.

Melissa Kuang Vietnam may be another market that will benefit from going digital. What is the outlook there? When are you planning to go in?

Piyush Gupta We do not have specific plans right now. It is about management bandwidth. We feel positive on Vietnam – you see investments moving there. Underlying growth is also good. The question is about pacing ourselves.

Melissa Kuang Will it be a pure digital bank?

Piyush Gupta No, we already have a branch there. Our business in the past year has done well. It is mostly corporate business. We do not have an SME or retail business. The idea would be to use digital – as we have done in other countries – to expand into the SME and retail space if we wanted to.

Nick Lord Your dividends look self-sustaining. Given we've got a period of economic uncertainty, are you quite happy to operate in your CET-1 range?

Piyush Gupta The reason we have a stated range is because we want to operate in that range.

Harsh Modi You talked about customer acquisition and fintech in India. Now you're going with physical branches. How is your customer acquisition cost shifting in India?

Piyush Gupta We are only branching enough to create brand presence and to meet regulations requiring a physical presence to market in the vicinity. The other reason is that SMEs need some points of presence for documentation. Our customer acquisition cost has come down quite dramatically from $66 per customer to $10. More importantly, we needed to understand customer quality. It was a big learning experience for us in the first two years. We got a lot of customers, but when we took a deeper look, half of them were never going to be profitable. That's why we pivoted from our learning and sharpened up for Indonesia. We have scaled down the number of customers but are now getting much better profiles. That was what brought us to be close to our revenue per customer targets.

Diksha Gera What is your ideal loan mix in India in two or three years?

Piyush Gupta Two to three years are not enough to move the needle. Today, we are booking secured loans of about $8 million to $10 million a month from India and Indonesia. They have doubled over the past year. They are small now but we expect them to grow exponentially. For SMEs, we have just started only two to three months ago.

Aakash Rawat What drove the general allowance increase this quarter, because there was a write-back in the quarter. What changed?

Chng Sok Hui The previous quarter's $100 million write-back was due to three factors: a transfer to specific allowances for weak exposures that became NPLs, a reduction in weak exposures from managing them out, and an improvement in market conditions compared to the fourth quarter. In the second quarter, the first two factors were also present. But the macroeconomic and geopolitical situation looked much worse compared to the first quarter, so we increased the amount of the management overlay. It is no different from what most UK banks do for their management overlay as a result of an uncertain outlook from Brexit. You have to articulate, record and justify the adjustments.

Piyush Gupta And the auditors have to sign off.

Aakash Rawat Do you have any intentions to disclose more details around your ECL framework? The European banks are doing that.

Chng Sok Hui Last year, when we first published our ECL disclosures, we were told that ours were the most comprehensive in this part of the world. We will see what additional disclosures can be made.

Nicholas Teh (Credit Suisse) You said there's a bit of flexibility on costs, but if I'm looking at the longer term, where would the cost-income ratio go if we see more pressure on revenue than you expect?

Piyush Gupta I have not given it too much thought but if there is a period of time – a year or so – when our cost-income ratio has to rise then we would live with it. It is not something we would want.

Robert Kong Are you seeing more pressure in the deposit mix with savings going down everywhere? In other markets, there's been quite a clear shift.

Piyush Gupta Everywhere, including Singapore. We held market share although the system is clearly shifting from savings to fixed deposits. In the past when interest rates are on an upcycle, it always happens. But the pressure has already moderated and could reverse.

Michael Sia Thanks for coming. We will see you next quarter.