Edited transcript of DBS second-quarter 2020 results conference call for buy and sell sides, 6 August 2020

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

Aakash Rawat (UBS) Five percent of DBS's total loans are under moratorium whereas UOB disclosed a number around 16%. Please comment on the difference and how you see it changing. Are there any updates to the first-quarter guidance of loans under stress?

Piyush Gupta The take-up rate was fastest in the early part of the quarter but it levelled off in June. At the moment $12.6 billion of the SME book and $5.7 billion of the consumer book are under moratorium. We have a smaller percentage of loans under moratorium because large corporates form a bigger proportion of the loan book.

We have also granted new loans under the government guarantee programme where we only take 10% of the loan's risk. More than $4 billion have been approved, but only $2.5 billion was drawn down by the end of June and we can expect further drawdown in the third quarter.

Delinquencies have not increased in either of the SME or large corporate books. But we are seeing some signs of stress in the unsecured consumer space.

Aakash Rawat You said three to five years of digital adoption have been compressed into the last three months. Has this changed your thinking around branch strategy and do you see the need for fewer branches than in the first quarter? Also, how are you thinking about the dividend for next year?

Piyush Gupta We have been automating branches over the last three to four years using virtual teller machines, branch teller machines and digital ATMs. We may need fewer physical outlets in Singapore over the next years, although not necessarily in other countries. Outlets in India are actually increasing.

On dividends, MAS has guided us to hold dividends at 60% of last year's level until the first quarter of next year. Without this guidance we would have been able to maintain the dividend. If the situation worsens beyond what we anticipate then we will revisit our thinking around dividends, but if events follow expectations we have the capacity to raise dividends next year.

Robert Kong (Citigroup) What was the exit NIM at end-June and where could it be at the end of the year? Can you share any thoughts on net interest income?

Piyush Gupta The exit NIM for June was 1.58% with about a six-basis-point impact from surplus Casa. We will manage to income and ROE not NIM. The $20 billion of surplus low cost Casa was helpful as it allowed us to generate income by placing it with MAS and earning 50 basis points. It also helps ROE as these assets are zero risk-weighted.

We expect NIM to be lower over the year as our housing portfolio gradually reprices. This will come through over the next several quarters so we expect NIM to bottom out at around 1.50%.

Our interest rate sensitivity is about $8 million per basis point so with interest rates around 100 basis points off that's about $800 million. Then there should be some impact on interest income in subsequent years. So that works out to roughly $10 million a month.

Robert Kong Provisions are expected to come in at between $3 billion and $5 billion. With relatively few loans under moratorium, is there scope to improve on expectations? What is the assumed peak NPL ratio?

Piyush Gupta Our analysis of cashflow to identify vulnerabilities has been robust. The larger names, comprising 95% of the large corporate portfolio, have been analysed individually while portfolio estimates have been applied to the rest of the book.

Most of the loans under moratoriums are from the SME book. We take comfort from the fact that 90% of the book is secured mostly against property and that collateral loan-to-value ratios are generally below 70%. The tail risk event that could take us beyond our $3 billion to 5 billion range is property prices across Asia collapsing by 50%. However, at this point we have sufficient collateral cover on the portfolio. Modelling takes rating migration into account but it is better to think in SP terms and what total credit losses might be than to carve out an NPL number on loans under moratorium. The outcome is likely to be in the range we provided, but if it falls below that is unlikely to be because of credit migration.

Harsh Modi (JP Morgan) How are you thinking about positioning for your rate outlook over the next 18 to 24 months? Does the 1.60% NIM guidance include some reversal of accrued interest in the second half?

Piyush Gupta The flat yield curve and low interest rates make extending duration unhelpful – there is little pick-up and it locks the book in. The exception is in the mortgage book because floating rates are so low. Five-year fixed rate mortgages are at around 1.50% today so 80% of new bookings are in the five-year category at 1.50%. This is more to do with the fact that the floating rate is just uncompetitively priced.

But building duration anywhere else at these levels is hard to justify. Over the last two to three years we built a $35 billion to $40 billion duration portfolio with a view that rates might collapse, but that was built at a time when duration offered a yield pick-up. That is much harder to find today.

Activity is more tactical now taking advantage of occasional rises in the yield curve to build duration. A lot of time has been spent actively managing our balance sheet. For example, acquiring $38 billion of Casa allowed us to let $32 billion of fixed deposits run off. Similarly, on the asset side, we added duration through cross-border arbitrage or the cash markets as rates moved, but it's not easy to find those opportunities.

There is no interest accrual reversal built into the 1.60% guidance.

Harsh Modi Digital competitors have started to develop their own product distribution. They are small now, but are you concerned about fee pressure from insurance or wealth management price competition in the mid- to low-end? How are you offsetting that?

Piyush Gupta We are not worried for now as the impact will not be material in the short term. The best analogy is in Europe where a negative interest rate environment has persisted for years. European banks have been able to grow fee income by rethinking architecture. This is despite all the digital banks in the UK and Europe.

Nicholas Teh (Credit Suisse) How much unrealised investment security gains do you have and how should we think about realising these in the near-term and into 2021? Also, what proportion of loans under moratorium could become NPL? Given that these are highly secured what would the loss given default be?

Piyush Gupta Marked-to-market gains in the book are around $1.5 billion. Realising the gains involves a trade-off because realising them puts further pressure on our NIM. These are high-quality assets that were purchased at higher yields, so the question is whether to recognise the gains upfront or let them trickle through. This depends on the outlook on rates if there is a good opportunity to recognise the gains. Ultimately, it is a question of timing when the value trickles into the book.

On your second question, our loans under moratorium are not large, with thousands of customers. Security and property collateral in the SME book and the unsecured consumer book are helpful. These are the portfolios where the biggest challenges will be and that is why we have prudentially taken large general allowances ahead of time.

Chng Sok Hui The loss given default for these loans is relatively low.

Nick Lord (Morgan Stanley) First, what was behind the fall in wealth management loans in the second quarter? Second, as returns are likely to be low over the next few years given the low level of rates, what are your thoughts on capital consumption going forward? Are we in a space where there is going to be more demand for credit? Where will the balance be in terms of funding growth and funding payout from capital generated?

Piyush Gupta Wealth management customers sold assets and paid down their margin loans because of the volatility in March. Most of the drop occurred over March and April and then stabilised.

On your second question, RWA growth has been 4-5% over the past few years, which we have been able to support together with reasonable payouts. If credit demand is weaker going forward and capital is not needed there is no need to continue accreting capital. It is not clear that a dividend cut was necessary, so when central bank restrictions end, the capacity exists to increase the dividend beyond where it is. Whether it occurs and by how much would depend on the market outlook at that point in time.

Nick Lord As a follow-up, what are your thoughts around demand for capital and RWA growth over the next few years?

Piyush Gupta The impact of Covid-19 is unclear as are the megatrends around geopolitics, social politics and supply chain shifts. A significant amount of largely government and fiscal debt has been built up in the system and the extent to which that crowds out private-sector borrowing over the coming years is unknown. The level of default and bankruptcy in the SME sector and how long the recovery will take is another variable. So massive credit creation over the next two to three years would seem unlikely. We project a return to the normal rate of credit growth at the end of this year, but it still depends on how the situation unfolds.

Melissa Kuang (Goldman Sachs) First, how has the India book developed in terms of loans under moratorium? Is there any cause for concern? Second, what target ROE can we expect when credit costs normalise while rates are still low?

Piyush Gupta There are no loans under moratorium in India as we are not present in the SME segment there. In fact, India has been a bright spot for us. Our large corporate book has really gone very upmarket and the book is robust after being cleaned up between 2013 and 2018. The portfolio is holding up well.

On ROE, headwinds can be expected given the collapse in NIM but there are three drivers we are focusing on to mitigate that. First is on increasing non-interest income. We have had some success in augmenting fee income streams and we will double our efforts. Some European banks have been able to achieve that over the last three or four years and their example will be instructive. Second, we continue to look at our cost structure. In the short-term, we're being very thoughtful. While we have not resorted to retrenchments, we have to think very sensibly about the re-architecting of our cost structure over the next couple of years. The final driver is the level of credit cost we have. Whether these initiatives are able to offset the NIM decline over the next year or two remains to be seen.

Jayden Vantarakis (Macquarie) How much of the wealth management fees are recurring or trailing in nature? Also, are there any benefits from the Singapore government's job support scheme?

Piyush Gupta Most wealth management fee income comes from activity with trailer fees only around 10% of the total. It comprises a small part of our wealth management income but has been gradually growing to the current level.

Chng Sok Hui The job support scheme reduced staff costs by 1% in the first half after netting against cost accruals because people are not taking leave.

Krishna Guha (Jefferies) How much of the $20 billion corporate loan growth in first half was for ESG loans?

Piyush Gupta Four billion dollars of loan growth in the first half were linked to ESG. We also arranged another $4.5 billion of green and social bonds.

Krishna Guha Do you see any changes on taxation either for yourself or for the wealth management segment? And how you are guiding your wealth management customers?

Piyush Gupta I believe we will see an environment with increasing tax rates and greater income redistribution over the next decade. That has to happen simply because of the social issues that we are facing. We are guiding our wealth management clients to consider succession management and estate planning. For companies, it is important that they do the right thing regarding tax obligations.

Krishna Guha How are you managing your structural exposure to Hong Kong?

Piyush Gupta We have been reshaping our Hong Kong portfolio over the past few years. Five years ago, SME loans comprised one-third of our Hong Kong corporate portfolio compared to only 15% today. Overall, the quality of the portfolio has improved.

Hong Kong and China are capable of holding the dollar-peg as long as they wish. If the peg goes, it will be driven by a Chinese decision, for example a switch to a basket or RMB peg. We conduct stress tests to determine our exposure and determine how to deal with such scenarios.

We have about $10 billion of capital in Hong Kong, about $4 billion or $5 billion of that supports the HKD book. If the value of HKD changes, the RWA and the capital will change proportionately. So, I don't think we have any structural issues. The remaining capital is used to hedge our USD book. We're looking at ways at which we can modify those positions.

Krishna Guha How do you see bank lending strategies evolve as industries change?

Piyush Gupta Take hospitality as an example, where we draw comfort from the nature of the sponsors. For example, in the case of a major hotel chain, you are banking on a large corporate balance sheet. But if hotel occupancies are 30% to 40% lower in the long term the sponsors will rethink their business model. Banks will similarly have to reconsider their financing strategy. We were part of the Singapore Airlines bailout because even with 95% of traffic gone the government stands behind the airline. At some stage the governments may rethink their strategy and we will have to be thoughtful about what to do.

Anand Swaminathan (Bank of America) What are your thoughts on the transition away from Sibor to the new benchmark? What is the timeframe and what could be the net impact on NIM? Also, can you share some colour on fund flows from Hong Kong to Singapore?

Chng Sok Hui MAS has announced how they plan to administer and support Sora corporate loans and bonds. We have issued bonds, loans and transacted derivatives. Price discovery is important and we have been posting prices.

Piyush Gupta MAS's intention is to ensure that customers' all-in yields are stable. This should not have a material impact on our earnings. Just that the reference rates will change.

On Hong Kong, We haven't seen massive outflows from Hong Kong recently. In fact, we saw more last year during the social unrest.

Michael Sia Thanks very much everybody for joining us. We'll see you next quarter.