CRO statement

Top and emerging risks

We understand that top and emerging risks can affect our business activities, financial results, reputation and our strategic priorities. That is why we proactively identify, control, mitigate, monitor and report these risks as part of our risk management process. We begin our identification process by reviewing internal risk data and industry research, after which senior management assesses our key focus areas, as well as the risk outlook for the banking industry as a whole. After further deliberation by the Board and management risk committees, our top and emerging risks are prioritised and monitored. Our action plans are periodically updated and this information is disseminated to the relevant risk committees.

Focus areas for 2016

1. Credit risk and portfolio management
2. Digitalisation - Cyber security
3. Regulatory compliance and reporting
4. Application development and insourcing
5. Digitalisation - Ecosystem partners, vendors and outsourcing service providers
6. Risk and control construct
7. Data management and protection
8. Resiliency and capacity (including crisis management)
9. Liquidity and capital management
10. Large programme initiatives

Of the above, there were three particularly challenging areas: (i) Credit risk and portfolio management, (ii) Regulatory compliance and (iii) Cyber security and data protection.

Credit risk and portfolio management

DBS faced a challenging operating environment in 2016 with headwinds from low oil prices and a slowdown in the Chinese economy. Challenges were seen in the segments of oil and gas support services and SME portfolios. We also faced pressure in sections of our commodity exposures such as steel and coal. In addition, our North Asia portfolio was impacted by the depreciation of the RMB. Despite these headwinds, our portfolios, especially in Singapore and China, continued to be resilient reflecting the inherent strength of our franchise.

Commodity prices have been under pressure since 2014. This has affected our oil and gas support services portfolio. Our exposure to the whole oil and gas complex – comprising not only producers and traders but also processors and support services – has remained around SGD 22 billion, of which SGD 18 billion was in the form of loans. Our exposure to the producer, trader and processor segments amounted to SGD 14 billion and remains resilient. The majority was granted to investment grade-equivalent borrowers, which include global trading houses, international oil companies and national oil companies. This exposure was typically in short-term and trade-related facilities.

Our exposure to the oil and gas support services segment amounted to SGD 8 billion, of which SGD 2 billion was to state-owned/government linked shipyards. Of the remaining SGD 6 billion, about half have been more affected by the decline in oil prices. We took allowances for three large exposures in 2016, of which two were in the offshore contracting business. This led us to re-evaluate our contract services portfolio and enhance the guidelines.

We expect the oil and gas support services sector to remain under some pressure due to structural overcapacity and low charter rates. While oil prices have rebounded off the lows, the slow recovery in prices indicates that capital expenditure by major oil and gas companies will remain constrained. Major oil companies have also driven down costs by renegotiating contracts across the exploration and production segments. We are closely monitoring this portfolio and working with our borrowers to re-profile their loans in line with the lower cashflows.

Our exposure to commodities other than oil and gas was SGD 21 billion, of which SGD 17 billion was in the form of loans. This portfolio, which is mostly in short-term and trade-related facilities, was spread over 400 borrowers. Close attention has been paid to the structure and collateral of individual trades. We have conducted several portfolio reviews and remain generally comfortable with our exposure. While there continues to be some stress in the steel and coal sectors, we expect credit losses to be manageable.

The shipping industry continues to be challenging. However, we draw comfort that majority of our borrowers have adequate financial resources to withstand the protracted industry downturn. We remain highly selective of new exposures and continue to focus on credits with strong track records and sound financial profiles.

The residential housing market in Singapore has remained subdued with property prices continuing to ease and transaction volumes remaining low. The outlook for commercial and industrial properties in Singapore has also weakened because of the slower macroeconomic environment. At the same time, the sharp rise in housing prices in Hong Kong and some cities in China has been an area of concern as it has heightened the risk of a sharp price correction. Because of this, we have stress tested our portfolio rigorously. We remain vigilant to any signs of market weakness and will continue to exercise prudence when underwriting new loans. Overall, we remain comfortable with our exposure to the property sector.

Across the region as a whole, there was no growth in exposure to the SME portfolio during the year, although growth levels varied between individual country portfolios. Credit quality was impacted by a combination of macroeconomic conditions and country or sector-specific issues, such as (i) the impact of RMB derivatives affecting clients in Hong Kong, China and Taiwan, and (ii) ongoing strains in the oil and gas support services sector in Singapore. The SME portfolios are subject to regular reviews, stress tests and ad hoc scenario assessments, with the results subsequently used to optimise lending criteria.

From a geographical perspective, in Greater China, our customers reduced their RMB positions substantially as they matured or through an early unwinding. The remaining contracts, with maturities up to the third quarter of 2017, are now quite small. For customers that have opted to unwind their RMB contracts, term loans have been offered to term out such liabilities where the credit risk is justified. We have taken specific allowances of SGD 173 million pertaining to customers with RMB derivative exposures.

In China, our customer and trade loans fell from SGD 37 billion at the end of 2015 to SGD 34 billion. The drop was due largely to the trade loans, which now accounted for half of the exposure, or SGD 17 billion, and were mostly backed by letters of credit issued by top-tier financial institutions. The bulk of the remaining SGD 17 billion of non-trade exposure was to well-rated large corporates. Our exposure to SMEs also declined as we continued to tighten our lending criteria. In the property sector, we are focused on the top local and international names.

The banking sector in India continued to be impacted by stressed assets. The recent demonetisation has also impacted short-term growth momentum. Downside risks remain for borrowers in weaker sectors such as infrastructure and engineering procurement and construction, as well as commodities such as steel as they continue to face challenges such as stalled projects, overcapacity, a downturn in commodity prices and the dumping of goods from other countries. While recent government initiatives, such as arbitration claims, the Bankruptcy Code and the Insolvency Act, are positive for our borrowers, our portfolio in India continues to be challenged due to industry and macroeconomic issues as well as slow progress in de-leveraging. We have tightened our Target Market and Risk Acceptance Criteria[(1)] and continue to actively monitor the portfolio, paying particular attention to identifying warning signals at an earlier stage.

From a country transfer risk perspective, our operations are concentrated in a few countries. In 2016, we paid closer attention to China as its economy slowed and the momentum of capital outflows picked up as interest rate differentials moved in favour of USD assets. Policy actions have been introduced to manage the capital outflows.

Although China's foreign exchange reserves have declined, they remain large enough to smoothen exchange rate volatility and serve as a cushion against external shocks. We also believe that the government has sufficient monetary and fiscal levers to weather an economic downturn. There is no material change in our assessment of China. We will continue to keep a close watch on policy development and actions.

Regulatory compliance

The key areas which required attention in 2016 were anti-money laundering efforts, sales process (client suitability) in RMB derivatives and cross-border taxation.

The Monetary Authority of Singapore (MAS) took action against us for breaches of money laundering regulations attributable to events in 2013 and 2014. The issues giving rise to the breaches – centred on onboarding, transaction monitoring and suspicious activity reporting – have been rectified. In 2017, we will be focusing on greater enhancements to our anti-money laundering capabilities including front office controls and training, enhancements to transaction monitoring and leading or participating in efforts to share more information on criminal behaviour with law enforcement and our regulators.

We were subjected to regulatory actions in Taiwan for lapses in sales processes on derivatives. Actions are under way to implement enhancements aligned to the Taiwan regulator's expectations. We operate, globally, a standardised process for classifying product risk and matching this to client risk before a product is sold to a particular client. The data is reported to the Fair Dealing Committee, which submits a quarterly report to our Board Audit Committee. The Fair Dealing Committee will, from time to time, instruct any relevant global enhancements which are appropriate in connection with derivatives sales.

As part of the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) and its local adoption by tax regulators, DBS is required to provide additional documentation in respect of "Country-by-Country Reporting" and Transfer Pricing documentation. In addition, BEPS has heightened the focus on cross-border tax issues in general. DBS has implemented relevant tax policies and procedures in response to this. We aim to apply both

(1) We use Target Market (TM) to define industry and geographical target markets and identify acceptable business/industry segments. Risk Acceptance Criteria (RAC) is used as a client screening tool to guide credit extension and how much risk is acceptable or tolerable.

the letter and the spirit of tax laws in the jurisdictions in which to operate and support the work by OECD and others to promote transparency. As local tax regulators start to adopt the BEPS action points, we would expect an increasing amount of tax audits focussing on cross border tax arrangements.

Cyber security and data protection

As cyber-attacks against public and private infrastructures grow worldwide, cyber security has become increasingly important for both governments and regulators across the globe. DBS takes an approach which converges the management of physical, cyber and data-related risks into a central Chief Information Security Officer, who also oversees the financial crime risk management programme. We take an overall approach of defence in depth, combined with employee education and industry collaboration; and we keep abreast of techniques and threats as they evolve in order to develop the appropriate countermeasures.

Data protection and governance are cornerstones for customers' trust in the banking sector, and are also critical enabling factors for innovation in a digital economy. In 2016, we had a data related incident in Hong Kong which was reported in media, stemming from reports which we submitted to the authorities. It remains our belief that it is important to supply information which facilitates prosecutions of criminal activity. We will be putting more focus in 2017 on controls to detect or prevent loss of data, as well as improving our policy framework around data management.

Our top focus areas in 2017 are similar to 2016's, with the top three remaining unchanged, as follows:

1. Credit risk and portfolio management
2. Cyber security
3. Regulatory compliance

For more details on our principal risks and risk management approach, please refer to pages 77 to 102.