Interview with CEO

Q1 ***With China facing its slowest growth in 25 years, the Singapore property market sputtering, and other emerging macro issues on the horizon, are you comfortable with the quality of your asset book?***

A Yes, we are. Our overall loan book continues to be clean, as demonstrated by our low non-performing loan rate of 0.9%. We have a system to monitor early signs of weakness in our portfolio and the number of such loans remains relatively small.

Having said that, we have been in a very benign part of the credit cycle and a slow reversion to norm is to be expected. While our specific allowances rose from 10 basis points (bp) of loans two years ago to 18bp in 2014, we are still well below the through-the-cycle average of around 25bp. While we do not expect specific allowances to be significantly higher in 2015, we will continue to be vigilant.

I am less concerned about systemic risks in China as I do not believe that its economy will have a hard landing. However, there could be idiosyncratic counterparty risks as the ongoing anti-corruption drive could create risks for companies related to the affected individuals. We have kept the majority of our China exposure in short-term trade loans; furthermore, most of our trade loan counterparties are the systemically-important China banks. Our non-trade loans are diversified. Our property loans have been made to leading local and international developers at conservative loan-to-value ratios. Overall, we are not seeing any unusual signs of stress at present across our China portfolio.

The Singapore housing market remains subdued after several rounds of cooling measures. We have stress tested our portfolio rigorously and assessed it to be resilient. Our typical Singapore housing loan is only 60% of the current market value of the property, and around 90% of our customers are servicing only one housing loan. We are therefore well-protected against downside risks.

We would not be surprised to find a few casualties in the commodities and energy sector given the sharp deterioration in prices. Again, we have stress tested our portfolio and have found only a handful of potentially weak cases, none of which is likely to be material.

We expect some upside in our India portfolio as the worst of the issues we faced in mid-cap segment are likely to be behind us. We have tightened our lending criteria and strengthened our early warning monitoring. We are encouraged by the government's decisive steps to improve India's economic framework. Together with declining inflation and falling oil prices, we expect the Indian economy to improve in the foreseeable future.

Q2 ***Some of your competitors are seeing funding pressures. Are you facing similar concerns?***

A Funding has never really been a challenge for us, given our very large corpus of SGD savings account balances, for which we have a 52% market share. This steady funding base has allowed us to comfortably grow our loan book. This remains the case even with the recent tightening of domestic liquidity: we continue to have a healthy surplus of SGD deposits, allowing us to remain above the fray in the competition for fixed deposits. Maintaining our deposit franchise leadership of course does not come by easily. We have been continually expanding our distribution channels and improving convenience for customers.

The real story, however, is the strides we have made over the past five years in growing diversified USD funding capabilities. We built out a leading cash management franchise as part of efforts to garner USD deposits. This strategy has proven to be extremely successful. We have made significant inroads with a diverse range of customers including Western MNCs, regional Asian corporates and institutional investors. Over the past five years, our USD deposits have tripled from around SGD 30 billion to SGD 90 billion.

We have also built up wholesale funding programmes, through commercial papers and medium-term notes, to access high-quality funding across a range of tenors. Our strong credit ratings allow us to command excellent pricing in wholesale markets.

Our overall loan-deposit ratio (LDR) of 87% remains very comfortable. The LDR is not necessarily the best way to measure liquidity (for example, a short-term trade asset funded by short-term wholesale funding poses no liquidity risk but has the effect of raising the LDR). That is why the focus has been shifting to alternative measures such as the liquidity coverage ratio. On this measure we are well over 100%, which is the regulatory requirement in 2019.

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DBS has put in place a number of organisational safeguards which help to maintain a strong risk and governance culture in the bank.

Q3 ***How do you view the digital revolution? Is it a boon or bane for banks like yourselves?***

A The digital revolution will fundamentally redefine the banking industry in just a few short years. We are perhaps the most digitisable of all industries as we deal only in bits and bytes. It is only a matter of time before the disruption that the retail and telecom industries have experienced befalls banking. Monumental change is just around the corner and Bill Gates will be proven right when he said that people need banking, but not banks.

Three trends will be fundamental to the future of banking. The first is mobile computing, which allows banking to become integral to people's lives instead of a detached activity. The second is big data, which will enable banks to introduce products and services that could not be imagined before. The third is the network economy, which dramatically changes the way economic agents – whether individuals or merchants – interact.

These trends will create a massive discontinuity and threaten traditional banks' existence. An insidious consequence of the recent financial crisis is that our industry has been so preoccupied with the issues of capital, liquidity and ethical conduct that we have been unable to prepare adequately for the digital future. This has allowed non-bank competitors and internet companies to make some of the biggest inroads into financial services in recent times. The biggest payment company in the region today is Alipay, an online payment platform linked to Alibaba, and not a bank.

At the same time, however, the discontinuity will provide a huge opportunity for banks that can get it right. Banks have innate advantages that others don't, such as banking expertise, robust networks and infrastructure, and established risk management frameworks, to name a few. If we can marry these strengths with the agility of internet companies, there is no reason we cannot carve out a befitting space for ourselves in the new world order.

I believe we are nearing a defining moment for traditional banks; some will make the transition, but many may not.

Q4 ***We have seen phenomenal regulatory fines/ sanctions imposed following investigations into the conduct of business and financial crime activities. What safeguards are there within DBS to drive the right behaviour?***

A We believe that effective safeguards against undesired business conduct have to go beyond a "tick-the-box" mentality. We cannot place sole reliance on published codes of conduct. Instead we advocate six organisational safeguards to maintain a strong risk and governance culture:

- **Tone from the top:** The tone set by senior management is important; it is equivalent to the moral compass of the organisation. Beyond having comprehensive policies, we seek positive confirmation that these are being rigorously adhered to.

- **Aligning strategies and incentives via balanced scorecard:** We developed a balanced scorecard, which forms the basis for rewards, in 2009 to align organisational strategies and incentives. The scorecard ensures management delivers shared value to

DBS CEO Piyush Gupta and Bridget van Kralingen, Senior Vice President, IBM Global Business Services, at a DBS-IBM collaboration signing ceremony. DBS is deploying IBM's Watson cognitive computing innovation to deliver a next generation customer experience.

all stakeholders. In particular, business interests are balanced with a focus on risk management and internal controls, which account for one-third of the scorecard scores, reflecting their importance to us.

- **Respecting voice of control functions:** We believe that respect for the voice of the control functions is a key safeguard. Many case studies have shown that control functions that have been marginalised by dominant business units lead to organisational disasters. We ensure that control functions are well integrated into our organisational structure so that they can properly discharge their responsibilities.

- **Having established escalation protocols:** We designed a notification protocol that makes it mandatory for staff to report significant incidents. This means that the organisation is prepared to receive bad news and take necessary remedial actions without shooting the messengers.

- **Encouraging constructive challenges at all levels:** More fundamentally, we inculcate a culture that encourages constructive challenges and debate, where all views are evaluated for decision-making. We also operate a culture where we actively engage the Board of Directors for their views early.

- **Reinforcing cultural alignment:** Finally, we conscientiously reinforce our cultural norms by rewarding right behaviours and censuring wrong ones. It becomes apparent to staff that certain ways of doing things, such as disregarding different viewpoints or reacting with aggression, are not tolerated.

Q5 Despite the persistent low interest rate environment, DBS has had successive record earnings over the past five years. What have you done to re-invent yourself and what are the bank's prospects going forward?

A Over the past five years we have doubled earnings and increased income by almost 50% despite low interest rates. I attribute our success to substantial progress in three broad areas.

First, we developed alignment across the organisation. We ensured everyone had a common understanding of our strategy and worked coherently to achieve objectives. This enabled us to build and transform business lines – such as transaction services, wealth management, small and medium enterprises and capital markets – that today operate on a vastly different scale, one that is truly regional. We re-directed our treasury business to supporting customers' needs. This, in turn, has ensured that our growth is underpinned by recurring income streams and is therefore sustainable.

Second, we made what I call the "plumbing" of the bank robust.

We improved our risk management by defining our risk appetite, drawing up regional frameworks and strengthening our credit risk architecture. We beefed up the resiliency of our technology platforms. We re-architected our management information systems to enable us to measure profitability at granular levels including branch, segment, product, industry and customer profitability, as well as risk-adjusted profitability at the customer level.

Five years ago, we set up a dedicated corporate treasury function that is focused on the stewardship of our capital and balance sheet. We developed various tools that help us steer the balance sheet to the desired asset and liability profile; we built new USD funding capabilities from new customer segments and supplemented this with cost-efficient wholesale funding; and we have a thoughtful approach to management of capital, liquidity and duration.

Third, and perhaps most fundamentally, we embarked on a journey to transform our culture into one that embraces innovation, decisiveness, entrepreneurship and nimbleness, one that places the customer's perspective at the centre.

Our financial success has been corroborated by the numerous awards we have been winning – we have moved beyond domestic awards to attaining regional and global recognition across a wide range of products and services. All these show that the overhaul we have made is deep and extensive. Investors too have recognised the progress we've made. DBS shares reached a multi-year high in 2014. We have seen an increasing number of high-quality, long-term institutional investors among our largest shareholders, which is an encouraging endorsement of our strategy and execution.

We are confident that the multiple business engines we have built are sustainable and scalable. We are convinced about Asia's potential and our ability to capitalise on it. The investments we are making in digital banking will enable us to accelerate our access to emerging markets and be a differentiating factor from competitors.

As we deliver earnings growth and better returns, higher interest rates will provide icing on the cake. We estimate that every 1% point change in interest rates affects the return on equity (ROE) we generate for shareholders by 1-2% points. Given that current interest rates are about 2% points below historical norms, we believe our ROE has meaningful upside.

Q6 So what's next for the regulatory reform agenda? Is Basel III fully bedded down? We've noticed that DBS is very comfortable with the new capital, liquidity and leverage requirements – can we expect more dividends in view of the strong profitability?

A Broadly, I think the main pieces are done: higher capital requirements, better capital quality, clear focus on leverage and liquidity. Other reforms, such as central clearing of over-the-counter derivatives, margining requirements and the risk governance of central clearing counterparties, will take longer to work their way through the various jurisdictions, and this aspect of regulatory change is complicated by extra-territorial regulations that are not always aligned. In addition, the increased tendency by national regulators to ring-fence capital and liquidity remains on my radar screen.

On the capital aspects of Basel III, attention has shifted to risk-weighted assets (RWA) computation. The use of internal models has come under closer scrutiny as the outcome of internal modelling excesses becomes apparent. The RWA density (RWA to total assets) of banks can vary widely, and not all of this can be attributed to a difference in risk profile. Indeed, regulators have realised through quantitative studies that the extent of modelling latitude within banks often results in unwarranted variations in the RWA that they compute for similar exposures – and this has been observed for both credit and market risks.

The regulatory community has initiated consultations on how a more basic RWA computation framework (what the industry terms standardised approaches) could be put in place for credit, market and operational risks. More importantly, the output of these methodologies would be used to determine how much benefit banks should be given from using internal models. If you will, it looks like there is a Basel IV on the horizon that pays a fair degree of homage to Basel I. Based on current calibrations, an increase in RWA is a very likely outcome, although the anticipated impact for DBS would be more moderate in view of our high RWA density. Pending further clarity on these developments, while we are cognisant that higher dividends do improve shareholders' returns, I think a watch-and-see stance is appropriate for the moment.

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