CRO statement

Focus areas for 2017

1. Credit risk and portfolio management
2. Cyber security
3. Regulatory compliance
4. Digital technology, application development and insourcing
5. Data protection
6. Ecosystem partners and outsourcing service providers
7. Risk and control construct
8. Crisis management and disaster recovery
9. Liquidity and capital management
10. Large programme initiatives

Of the above, we focused our attention on the following four areas: (i) Credit risk and portfolio management, (ii) Regulatory compliance, (iii) Cyber security and data protection and (iv) Large programme initiatives.

Top and emerging risks

As part of our risk management, we identify and monitor the top and emerging risks that affect our business activities, financial results, reputation and strategic priorities. It begins with the identification process, where we review internal risk data and industry research. Thereafter, senior management assesses our key focus areas and the risk outlook for the entire banking industry. This is further supplemented by discussions with the Board and management risk committees where our top and emerging risks are prioritised and monitored. We carry out periodic updates on our action plans and this information is disseminated to the relevant risk committees.

Credit risk and portfolio management

In 2017, there was a broad-based pick-up in global growth, while inflation remained benign. Asset prices were elevated, supported by the prolonged period of low interest rates which kept borrowing costs subdued. Asia, in general, benefitted from the upturn in global activity and exports finally picked up. However, the operating environment remained challenging for DBS in 2017, due to the prevailing credit conditions. Notwithstanding this, our credit risk portfolio grew by 6% in 2017. As we continue to look for areas of growth, we remain vigilant in credit underwriting, particularly in the segments highlighted below.

For the large part of 2017, oil prices were generally subdued, gradually trending upwards only in the later part of the year. The low oil prices continued to adversely impact our already stressed oil and gas support services portfolio.

Our exposure to the whole oil and gas complex – comprising producers, traders, processors and support services fell from SGD 22 billion to SGD 21 billion. This decline was largely attributable to write-offs of non-performing exposures to, as well as repayment of loans by borrowers from the support services sectors as they managed down debt levels. Our exposure to the producer, trader and processor segments remained around SGD 14 billion. Overall credit quality remained satisfactory with 86% of this exposure attributable to international oil companies, national oil companies, state-owned enterprises and investment grade equivalent borrowers.

Our exposure to the oil and gas support services segment fell from SGD 8 billion a year ago to SGD 7 billion, of which SGD 2 billion was to state-owned/ government-linked shipyards. Of the remaining SGD 5 billion, about 86% has been impacted by the decline in oil prices.

While we have seen oil prices trending upwards recently, we are of the view that the sub-segment involving deep sea drilling and development is structurally challenged on a secular basis given the impact of shale and shift to renewable energy.

The shallow water support services sub-segment is facing cyclical pressure. Despite Brent trending upwards in the second half of 2017 and breaching the USD 65 per barrel mark, there has been no easing of cost-cutting measures adopted by oil majors to adapt to oil prices at previous levels of USD 50 per barrel. Recovery in the sector is dependent on vessel scrapping, which has been minimal to date. Significant vessel supply imbalance and intense competition have left the fragmented support service players with little pricing power; their operating margins are not improving meaningfully and revenues are only enough to cover operating expenses in most cases.

As the sector is not expected to recover anytime soon, we decided to adopt a more conservative approach and classified remaining weak oil and gas support services exposure as non-performing assets (NPAs) although the bulk is not technically overdue.

The steel sector generally improved in 2017. There was capacity reduction in China resulting in a rebound in domestic steel price and a cut in export volume. Certain countries also benefited from anti-dumping measures. That said, we are still cautious about the steel sector and have (i) reviewed and rationalised our steel portfolio and exited weaker borrowers, and (ii) tightened our Global Industry Target Market and Risk Acceptance Criteria (TMRAC) for the steel industry. Portfolio quality has stabilised since end 2016 with no new NPA.

The general shipping environment improved in 2017 with sustained volume growth and an uptick in freight rates. However, we remain cautious about our outlook due to expectations of supply of vessels (arising from new deliveries) outpacing demand in 2018 and ongoing consolidation among the global liners. We have assessed the debt servicing abilities of the borrowers in the portfolio and we do not expect a significant deterioration in credit quality as we continue our focus on players with strong cashflows and good credit profiles.

On our real estate portfolio, the residential housing market in Singapore has been showing signs of recovery with a slight rebound in prices and higher transaction volumes. Sentiment in the market has improved considerably with a buoyant collective sales market and keen interest in the government land sales programme. Most other real estate subsectors in Singapore have also turned the corner on the back of improving demand-supply dynamics. Abating supply risk is driving prices and rentals higher, as evidenced in the office and hospitality subsectors. We believe the positive momentum seen in 2017 will spill into 2018. However, we are cautious about the outlook for retail subsectors as they face increased competition from e-commerce, although some mall operators have been actively repositioning their malls with new tenant mix to meet the changing demand and lifestyle of consumers. The outlook for industrial properties remains weak, though selected industrial properties such as logistics warehouses and business parks will have better prospects.

In Hong Kong, housing prices have continued to rise sharply to record levels despite various cooling measures, heightening the risk of a sharp price correction. Nevertheless, more than 95% of our residential mortgage exposures in Hong Kong have a current loan-to-value of less than 50%, thus providing significant protection against the risk of price correction. In China, housing prices have also continued to rise, albeit moderately under the control of price caps and other policy measures introduced by the authorities to rein in the market. We are also seeing significant investments into real estate markets in London and Australia, particularly into income-generating assets such as office, hospitality, logistics, and some residential properties. We believe the trend will continue, a manifestation of the diversification strategy of some industry players, as well as the comparatively attractive returns of these investments. While we are comfortable with our exposure, we remain vigilant to any signs of market weakness and will continue to exercise prudence when underwriting new loans.

Our SME portfolio did not grow in 2017 because we focused on improving credit quality, particularly in Greater China. The largest portfolio, Singapore, experienced modest growth but continued to face ongoing challenges in several sectors such as building and construction, and offshore marine engineering. All portfolios remain subject to a mix of regular and ad hoc stress tests and scenario assessments; the results are used to refine business strategies and lending criteria.

From a geographical exposure perspective, our China portfolio grew in large corporates and shrunk in SME, while our Indian portfolio shrunk marginally.

In 2017, selective credit loosening by China's policy makers stabilised the domestic economy while the global upturn supported its export rebound. As capital outflow and RMB depreciation fears eased on the back of renewed confidence in the economy, international reserves started to climb steadily to the current level of USD 3 trillion. The outcome of the 19th National Congress in late 2017 suggested that economic reforms will remain high on the government's agenda. As the quality and sustainability of growth get prioritised, policy will shift to address critical concerns such as environmental degradation and unfettered credit expansion. A tapering of economic growth towards a more sustainable level is on the cards for the next few years.

Changes in our China portfolio were in line with a more focused business strategy and tightened lending criteria. In the real estate segment, strong growth potential was observed from modern logistics warehouse financing driven by high growth of online sales in China.

In 2017, China registered significant improvement in impairment charges from the SME segment and there was no new NPA from the large corporate sector. Asset quality of the portfolio is anticipated to remain satisfactory and manageable in 2018.

The Indian economy was impacted by the lingering effect of cash shortage from demonetisation and destocking ahead of the roll-out of Goods and Services Tax (GST), although some recovery seems to be underway. Recent measures to fine-tune GST compliance and the announcement of a large recapitalisation plan for public sector banks are encouraging moves. Private investment sentiment however, continues to be muted and banks continue to be saddled with a rising stock of bad loans.

The quality of our portfolio in India was stable in 2017. Our portfolio is expected to grow with increasing coverage of SMEs and wider reach on the retail side to include digibank customers. Sectors which were stressed due to high debt burden and pricing pressures, such as infrastructure and engineering, procurement and construction, power, commodities and telecom, are expected to pick up. Increase in planned investments in the infrastructure sector will augment the growth. Our local risk management strategy continues to be prudent through active portfolio reviews, selective onboarding of new businesses and diversification of our portfolio.

Compliance and regulatory risk

Improvements have been made to processes and controls in dealing with financial crime risk and fair dealing.

We executed our commitments in our 2016 annual report to implement enhancements to front office controls, transaction monitoring and collaboration with regulators.

The front office has strengthened its ability to identify and act on thematic risks. These include heightened geopolitical risks which often translate into sanctions laws or greater sensitivity around sanctions enforcement. We have also made improvements to address specific typologies, such as certain higher-risk trade corridors and dual-use goods.

Process and system improvements have been made to areas concerning customer due diligence and transaction surveillance to materially improve prioritisation of risk areas, and clear any accumulating operational congestion. This work will continue in 2018.

We are members of the Anti-Money Laundering/ Countering the Financing of Terrorism (AML/ CFT) Industry Partnership, a public/ private sector collaboration launched in 2017 to share financial crime risks and typologies, and mitigations.

With regard to sanctions risk, in 2017, Singapore broadened laws prohibiting direct or indirect business connected to the Democratic People's Republic of Korea. There are also public reports of suspicious commercial typologies designed to facilitate evasion of sanctions laws which DBS is subject to. In 2018, we will focus on controls and processes to detect and prevent the same, making improvements particularly as more suspicious typologies are known. Also in 2018, we expect results from a number of initiatives relating to our surveillance systems and Know Your Client (KYC) processes, including robotics process automation, analytics and artificial intelligence, and national-level KYC utilities.

Regarding fair dealing, significant improvements have been made in Singapore in using data analytics to predict whether there is a need for greater supervisory attention or action in the case of certain relationship managers and/ or customers which may be more vulnerable.

Group-wide metrics on fair dealing are reported to the Fair Dealing Committee, which submits a quarterly report to our Board Audit Committee.

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 onto a central Chief Information Security Officer, who also oversees the financial crime risk management programme. We implement multi-layered defences, combined with employee education and industry collaboration; we also keep abreast of techniques and threats as they evolve to develop the appropriate countermeasures.

During the year, enhancements were made in the implementation of a bank-wide CYBRFIT training and assessment programme, and the use of "red team" simulated attacks. We expect to continue to lift our capabilities in 2018, including collaboration with cybersecurity authorities and regulators since this is not merely a private sector issue.

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 2017, we made appropriate risk management decisions concerning how and when to use cloud infrastructure, and working from home on DBS devices. We have also deployed, and in 2018 will further scale, capabilities around monitoring for unusual employee behaviour in the use of data.

We are also increasing capabilities in light of the way risks will evolve with the digital landscape. This will manifest in changes in criminal behaviour and in the way customers interact with banks. Appropriate and proportionate consideration is given to many scenarios – such as speeding up customer authentication processes in low-risk situations, as well as improving intellectual property and security controls around ecosystem partnerships and application programming interface connectivity.

Large programme initiatives

DBS announced the acquisition of the wealth management and retail banking business of ANZ in five markets, namely Singapore, Hong Kong, China, Taiwan and Indonesia on 31 October 2016. The acquisition included credit cards, mortgage, revolving and unsecured personal as well as wealth management products.

Integration work started in early 2017 with China being the first location to be integrated successfully in July 2017, followed by Singapore, Hong Kong and Taiwan in August, September and December 2017 respectively. Total receivables from the ANZ acquisition in these locations amounted to SGD 8 billion as of December 2017. The final location is Indonesia where integration is expected to complete by the first quarter of 2018.

For Consumer Banking, we do not expect any significant impact on the overall portfolio quality as the observed loss norm in ANZ portfolio is similar to ours.

For Wealth Management, in terms of portfolio mix, ANZ collateral types largely resemble the DBS portfolio. There is no significant impact on the overall portfolio with the acquisition.

Risk culture

In 2017, DBS conducted a deeper and bank-wide assessment of our risk culture. A survey was designed and rolled out bank-wide using the Financial Stability Board guidelines.

Overall, the results from this survey indicated an appropriate risk culture across the organisation. The survey will be rolled out on an annual basis to allow us to identify certain trends and help with action planning moving forward.

Read more about our principal risks and risk management approach on pages 71 to 91.