Edited transcript of DBS fourth-quarter 2020 results conference call for buy and sell sides, 10 February 2021

Yeoh Hong Nam Welcome to the briefing.

Akash Rawat (UBS) Good morning and thank you for the call. How much of the loan book remains under moratorium?

Piyush Gupta Just over 1% of the loan book remains under moratorium. The mortgage book still has $500 million down from $5 billion at its peak, the Singapore SME book has $1.1 billion down from $4.6 billion, and the Hong Kong large corporate and SME book has $3.2 billion down from $6.6 billion.

Akash Rawat May I know what you are expecting in terms of credit costs?

Piyush Gupta We set just over $3 billion aside last year to cover credit costs for 2020 and 2021. Assuming costs for the two years come in around $4 billion, that leaves us with $900 million for 2021, or around 25 basis points of loans. That's similar to our credit cost under more normal business environments.

Akash Rawat I understand that no further capital outlays are expected for LVB, but how should we think of BAU costs and credit costs on an ongoing basis?

Piyush Gupta LVB should generate $150 million in income with about $120 million in expenses on a BAU basis. From a credit perspective, LVB had a $2 billion loan portfolio of which $800 million were gold backed loans. That's very small compared to our $370 billion loan book. We were also aggressive in recognizing NPAs and taking provisions upfront, so the impact on credit costs going forward should be limited.

LVB will help us grow the secured SME and the secured retail businesses as well as expand the wealth franchise linked to Singapore. We also plan to use it to help grow the deposit base. None of these are particularly credit intensive.

Chng Sok Hui We set $33 million of expenses aside to upgrade items such as premises and systems. All in all, we expect to be profitable in 12-24 months.

Akash Rawat What structural savings can we expect in the rest of the franchise?

Piyush Gupta We have an aggressive programme to reduce occupancy costs over the next two to three years. This includes actively reshaping our physical branch footprint to feature more digital branches and points of presence. Our corporate property footprint will also reduce by about 20% as we increase flexible working hours and work from home.

Akash Rawat What is the impact on P/L of the Digital Exchange?

Piyush Gupta We have only just opened, but other digital exchange start-ups have generated $30 million-$40 million of income from cryptocurrency volume and flow before adding security tokenization to provide liquidity on illiquid assets.

Nicholas Teh (Credit Suisse) What was the exit-NIM for this quarter? How easy would it be to replace excess deposits, placed in low-risk liquid assets, with wholesale funding to mitigate the impact on net interest income?

Piyush Gupta Last year's exit-NIM was 1.48%. The pace of decline slowed through the year with second-quarter 24 basis points lower than the previous quarter, third-quarter nine basis points lower and then fourth-quarter only four basis points lower. The bulk of the pain appears behind us and a range of 1.45-1.50% makes sense for 2021.

We could raise inexpensive wholesale funding easily and place it in low risk assets at a positive margin. Having reduced outstanding wholesale debt by more than $10 billion this year, it would be easy to reverse and raise CP at sub-Libor rates.

Nicholas Teh How should we think about gains from the sale of investment securities in 2021?

Piyush Gupta We still have $1.3 billion of unrealized gains in investment securities. The choice of booking gains or accruing the income is a function of our view on the yield curve.

Melissa Kuang (Goldman Sachs) Good morning. Are borrowers coming out of moratorium under restructured terms or under their original terms? And do you think LVB can be capital-generating in the next 12 to 24 months?

Piyush Gupta Payments on loans coming out of moratorium resume on the original terms and only a small number of borrowers are delinquent. We might have discussions with delinquencies in the normal course of business, but that percentage is low.

Chng Sok Hui We also note that all loans under moratorium are on a secured basis, whether they are SME loans or residential mortgages.

Piyush Gupta The RWA against the LVB book is not large and we anticipate earnings of $20 million-$30 million in the first year. That amounts to 4-5% ROE, which is below our cost of capital and not capital accretive, but we believe it will be capital accretive within two to three years.

Melissa Kuang May I ask how open banking has impacted your customer base?

Piyush Gupta Our experience on open banking has been very good. Over a million customers downloaded our financial planning tools since they were launched in April last year, and almost half a million use them for budgeting and planning insights. We were pleased that almost 50,000 customers used the tools to turn their cashflow from net negative to net positive. We also saw many customers import data from other banks to refine financial planning on their consolidated balance sheets. Overall, it's been strongly positive and has led to incremental take up of products.

Nick Lord (Morgan Stanley) What could the dividend policy look like going forward? How did you arrive at your NIM guidance of 1.45-1.50% for 2021 and how could the structure of the balance sheet affect this?

Piyush Gupta I have not spoken to the MAS and it is difficult to say what the regulator has in mind. One possibility is to return to our original dividend of $1.32 in two steps, with an intermediate step halfway. Having said that it would certainly be within our capacity to return in a single step.

Chng Sok Hui NIM of 1.45-1.50% is reasonable for 2021 as last year's exit NIM was 1.48% and that level appears to have held for January. Interest rates have also stabilised so any further downward drift will be due to loans repricing in 2021. There was a six basis points drag on full-year NIM as surplus deposits were deployed to high quality liquid assets, but that is actually accretive to net interest income and ROE.

Piyush Gupta The steepening yield curve is a tailwind that allows us to generate incremental margin by adding assets. It's premature now but we have surplus capacity and could add duration at the right level. That would be NIM accretive as well.

Harsh Modi (JP Morgan) What is the revenue opportunity on the Digital Exchange?

Piyush Gupta We believe $30 million-$40 million of revenue to be within reach, mainly from spreads as customers convert between fiat and cryptocurrency. Custody is another opportunity as money moves from existing exchanges to custodize with us. This makes us relevant in the context of third-party exchanges as well. Security token offerings are another interesting opportunity as they offer a way to improve liquidity on illiquid assets, but that's still a work in progress.

We're one of the few established institutions to have entered the space and so our approach has been measured. We managed AML/KYC risk by starting with professional counterparties and intermediaries, who are customers of our brokerage operation, as well as some private banking customers. Demand has been much higher than anticipated even within this limited group with 200 customers across the region wanting to use the platform immediately. But we're applying a suitability prism on our customers' understanding of cryptocurrencies.

We also check coins for purity to understand the background of coins coming into our wallets from third parties. There was a 0.002% trace element of possible dealings with North Korea in coins one customer wanted to move over, which was obviously not desirable.

I will discuss with the team to see what metrics we can provide around our progress in the space.

Harsh Modi What are the considerations before you start lengthening the duration of your portfolio? What instruments would you use?

Piyush Gupta It depends very much on the market outlook. Ten year US Treasuries could reach 1.40-1.50%, but we could start adding three to five-year duration at lower levels. What is interesting is that we can get better returns on duration through correct positioning across different asset classes.

Chng Sok Hui This activity is overall defensive in nature and small relative to overall interest-bearing assets.

Harsh Modi May we have your thoughts on the cost-income ratio?

Piyush Gupta Income will be lower from the full-year impact of lower NIM and costs will rise by a couple of percentage points. We can make up for that on the allowances line so growth will be healthy, but the cost-income ratio will deteriorate.

Chng Sok Hui At the end of last year we guided for costs to be around 2019 levels.

Jayden Vantarakis (Macquarie) Were the lower tax rates in FY20 and fourth-quarter the result of structural changes, and what income tax rates should we expect going forward?

Chng Sok Hui One factor lowering the overall tax rate is that profits realized on the sale of government securities are taxed at 0-5%. We also applied and received approval for a derivatives market incentive in the fourth quarter that reduced the tax rate for the business from 13.5% to 5%. That was a structural change as a segment of our Markets income will be taxed at the lower rate going forward.

Jayden Vantarakis Is there much scope to improve the structure of the deposit base and to manage funding costs? How does that factor in the NIM guidance?

Piyush Gupta We earn 40-50 basis points margin from placing inexpensive surplus deposits into high quality liquid assets. Although that constitutes a six basis point headwind to NIM, it's a sensible strategy on balance as it doesn't consume capital, is ROE accretive and P/L positive.

The question is about the availability of cheap funding. Government and central bank stimuli have boosted the M2 supply of money globally and we received a disproportionate amount of it in a flight to safety as well as through our digitally enhanced franchise. We can keep growing low-cost Casa as long as ample liquidity prevails.

Last year Casa grew $99 billion against a $40 billion run off in fixed deposits so there is still scope to improve the deposit base, but it's limited by the amount of fixed deposits we can run off. SGD fixed deposits are more stable as they tend to be from long-term customers, but we have been able to reduce USD fixed deposits. Those customers are more price sensitive and will uplift funds on a 5-10 basis points drop in yield.

Jayden Vantarakis Specific provisions in the fourth quarter included top-ups for existing NPA. Do you see any need for further top-ups going forward?

Piyush Gupta We topped up every case where we saw a chance costs might exceed what had been provided, so we don't anticipate further top-ups. The Singapore case which was in the news earlier in the year was topped up from around 80%.

Chng Sok Hui We also topped a number of cases up to 100%.

Anand Swaminathan (BAML) Does your surplus liquidity allow you to gain market share through more aggressive pricing?

Piyush Gupta We bid aggressively for deals that we want to win and where we have the credit appetite. But we're careful about adverse selection at times such as these and don't want to overextend from a credit standpoint. We're not missing deals on account of pricing so we’re careful about using the pricing lever unnecessarily. That’s because it would be very easy for us to lead pricing down and force everybody to follow. In the end that would just compromise margin in the whole system.

Robert Kong (Citi) Could you provide an update on open banking in Singapore? And what are your thoughts on digital start-up banks here and how the space is developing in Indonesia?

Piyush Gupta Customers can now aggregate their bank and government data with any participating bank, so the next step will be to include insurance and other third-party data as well. New digital banks are welcome to participate as long as they are part of SGFinDex, but unlike in Europe where tech leaders have only drawn on bank data, we require participants to contribute data if they want to draw on what is available.

About two years ago we realised that if an incumbent bank is sensible about customer journeys and can provide a good value proposition it can benefit from the system as opposed to simply being a victim. That triggered us to start thinking how to leverage open banking and financial planning at scale. And it’s working well – we’re benefitting as more customers come onboard and as engagement increases.

The digital new entrants are clearly formidable competitors with strong digital capabilities, but the three local banks are not short on the digital front either. And as we have a large part of the customer relationship it will not be easy for newcomers to exclusively compete on price.

Regulators are also becoming more watchful of the space. Recent events and consultation papers in China show how they are increasingly prepared to intervene when they see predatory pricing and monopolistic behaviour. Anti-tying regulations are also under consideration as regulators look to protect customers from being required to exclusively deal with certain parties in exchange for accessing a service. This means that the regulatory arbitrage that some new entrants used to enjoy may be narrowing. In the end competition is always something to be wary of but we’ve done enough to hold our own in Singapore.

Indonesia appears different as there is scope, particularly in consumer and SME finance, for players to be more aggressive. That market can however be challenging with delinquencies for new entrants considerably higher in the last quarters. But it remains a large underbanked market which should provide a good opportunity for digital players to scale up. Our Indonesia business is still relatively small and in a niche with ample opportunities to grow notwithstanding the new competition.

Yeoh Hong Nam Thank you for joining us. We’ll speak to you next quarter.