Edited transcript of DBS third-quarter 2021 results conference call for buy and sell sides, 5 November 2021

Yeoh Hong Nam Good morning, everyone. Thank you for joining our briefing with our CEO, Piyush, and CFO, Sok Hui.

Robert Kong (Citi) I have two questions. First, on NIM sensitivity, one basis point is now $18 million-20 million because of the much higher Casa. Could you give us more details because your book is multi-currency, with Singapore dollars only 40% of loans. Second, a bit more colour on the cost growth you're expecting. Costs this quarter were $1.67 billion. What kind of growth should we be expecting in the coming year?

Piyush Gupta On NIM, I'm going to ask Sok Hui to unbundle by currency. But the bulk of our sensitivity is in Singapore dollars. The Hong Kong book has turned from being fixed-deposit dependent to being Casa-dependent. Therefore, we also have interest rate sensitivity in Hong Kong, which comprises Hong Kong dollar and US dollar, as well.

Chng Sok Hui We took a blended sensitivity to the US dollar rate, with some modelling assumptions around how other interest rates are correlated and how much Casa could convert to fixed deposits. In the past we guided to $14 million per basis point, with the impact spread over a few years. But with the profile we have today, we find that the bulk of the $18 million-20 million crystallises within the first year. So, if we see a 100 basis point US dollar rate hike, we are talking about a $2 billion increase in net interest income, the bulk of which will be in the first year.

Piyush Gupta We've made some reasonably conservative assumptions around how Fed rate hikes flow through to our various books, and on how Casa might run off as people switch back to fixed deposits.

On expenses, we expect mid-single digit revenue growth next year assuming trading normalises, and expenses might grow a few percentage points above that. That's my current outlook.

Chng Sok Hui This quarter's $1.6 billion-1.7 billion is a good quarterly cost baseline that you could use to layer on increments for next year.

Akash Rawat (UBS) My first question is for some colour on the new NPAs and the recovery that you had this quarter. Second, can you share some more insights into the economics of the Digital Exchange, such as the revenue per customer we should expect in the steady state, what the sources of revenue are, and the commission rates?

Third, other than transparency, what are the benefits that Finnovation unlocks and what could lead you to spin it off? If you look at SCB, the opportunity for unlocking is when the customer base can be monetised right away; or growth constraints can be removed by a spin-off; or there is regulatory arbitrage, which you said is not likely to happen in Singapore. In my mind, none of these seem to be applicable to any of your businesses, for example Remit. I'm trying to understand if there is anything else apart from transparency that will make you spin off?

Chng Sok Hui There were $342 million of new NPA during the quarter. The top 75% contributed little to SP as we expect losses to be minimal. The national airline that was moved to NPA on a technicality accounts for one-third of the new NPA. The higher repayment this quarter was due to a recovery from the oil and gas sector.

Piyush Gupta In terms of unlocking value, apart from price visibility, there is the opportunity to increase customers using some of the capabilities we have built by going through intermediating banks' customer bases. As banks are generally circumspect about using another bank's tools to interact with their clients, it may be helpful to spin out and unbundle the business from DBS.

If you spin out an entity that has multiple-party ownership, where you keep a stake, then you can start accessing much larger customer numbers. Our plan for these businesses is B2B2C. We are considering a more detailed investor session next year to show case what we have, what businesses we can do this way and how growth can be enhanced.

On the Digital Exchange, it is premature to discuss the economics on a customer level but there are three drivers of overall economics. The principal one is cryptocurrency trading, where we make a spread on transactions. The second source of revenue is custody, similar to the custody business we do with other assets. This is promising because other exchanges are seeking us out for our digital custody capabilities. The third revenue stream is the origination and tokenisation business. We have done a fixed income transaction as a test case and we are planning a property tokenisation in the next few weeks.

Jayden Vantarakis (Macquarie) I would like a bit more colour on the GP release. Can I confirm that the amount above MAS requirements fell from $800 million in the previous quarter to $600 million? What were the variables that determined how much was released this quarter? What would you be looking at next year?

Piyush Gupta The GP overlays we have are well above $600 million. Since we have taken all our GP through the P&L, we can release a substantial amount of the overlays. If our GP reserves do not meet MAS requirements as a result, we could always make it up with the RLAR, which is what our two local competitors are doing. We currently have no RLAR.

Chng Sok Hui I'll make a few points. In 2020, we built up $1.7 billion in GP. In the nine months this year, $0.4 billion has been released but the overlay we have over and above the models remains substantial. Compared to our peer banks, we set aside a lot more allowances in 2020 and therefore are in a better position to release some.

You asked what variables we would consider. We have prepared a GP release framework that takes into account a few factors, such as when government relief efforts start to roll off and the delinquency trends after that; the extent of re-opening such as cross-border passenger traffic; and how stringent restrictions are in the countries we operate. Country stringency measures are published by Oxford University and look at workplace and school closures, transport and so on. If trends improve, we would be in a better position to release GP. The earliest this will happen would be first quarter next year.

Your third question was on the buffer above the 1% MAS GP requirement, which is really a capital construct. Last quarter the buffer was $800 million, this quarter it was $600 million. The decline reflects loan growth during the quarter. Any amount written back up to $600 million increases CET-1, while any written-back amount above $600 million will be CET-1 neutral.

Jayden Vantarakis That's helpful, Sok Hui. Can I just clarify what's the total overlay that you're still holding at this stage.

Chng Sok Hui We have a few types of overlays but the one that is most directly linked to the pandemic is about $1.3 billion. It doesn't mean that we're going to release the entire amount.

Weldon Sng (HSBC) I have two questions. First, on unlocking the value of digital assets, SCB moved some existing consumer businesses to the holding company. Can I clarify if Finnovation is specifically for just the digital businesses or will you also consider moving some consumer businesses under it? Second, what is the AUM split between mass retail and private bank?

Piyush Gupta Unlocking or unbundling a business will depend on the incremental value that would be created, and on how integral it is to core banking activities in terms of regulatory and other requirements. For example, a deposit franchise or deposit-linked business is much harder to unbundle because of depositor protection requirements, while asset-led businesses tend to be easier. Again, it is premature to talk about any specific business.

About three-fifths of our AUM are high net worth, and the remainder mass affluent. Retail wealth has been growing nicely.

Nick Lord (Morgan Stanley) A couple of questions. First, fees have been strong this year and you're indicating double-digit growth next year as well, whereas historically fee growth has been 5-10%. You've spoken about how digitalisation and investments have structurally increased fee growth, but cyclical factors and low interest rates also have helped. Do you think the changes you have made can drive double-digit fee growth consistently over the medium term? Second, could give us more detail about the China consumer business in terms of the loan book and your ambitions?

Piyush Gupta I think there is a secular change in our ability to generate fees, but I'm not totally sure how much of the double-digit growth is secular and how much is cyclical. Whether it gets to be consistently double-digit or winds up at 8% or 9%, I'm not entirely sure. Fee income is a function of rates and volumes. The bulk of our fee income increase comes from volume growth that has been broad-based. The volume growth for payments, for example, because of the digital and the API linkages we made, has been material over the past 18-24 months. Our payment volumes will continue to increase, both in corporate and retail cross-border payments. Similarly, trade finance has been plugged into many platforms and anchor-driven supply chains, and the volumes we are getting are quite material.

Cards have benefited this year from the economic re-opening, which I think will continue into next year. But beyond that, cards might be cyclical. Once you get to a steady state, will card fees continue to grow at the present rate? Maybe not. Our investment banking franchise is not big compared to the bulge-brackets but it can be quite material from year to year. That's a long answer to your question. I think there has been a secular shift in our fee income generation capability over time.

On the consumer finance business in China, we're not originating directly but through partnerships. One of the advantages for us now are regulatory changes limiting the number of consumer finance providers. A few firms have a nationwide licence to provide consumer finance, and we are one of them. We tie up with various origination platforms, we use our own underwriting mechanisms, we use our own tools on top of what they use, and we get access to customers, so we build the customer relationship as well but we originate through partnership platforms.

Nick Lord What sort of partners do you have, and will you consider buy-now-pay-later in China?

Piyush Gupta We have a whole range of partners, for example, Ctrip, and we also recently started with other partners. We have the choice of originating with micro-SMEs or consumers, but so far we've been focused on consumers, which is specific-transaction-linked and based on our algorithmic underwriting model. Whether you call it buy-now-pay-later or another name is less relevant than whether you can use the data and the transaction flow to do sensible credit underwriting.

Nick Lord What size is the business at the moment?

Piyush Gupta I am trying to remember the asset book. I will get back to you Nick. [Post-script: the size is $250 million.]

Melissa Kuang (Goldman Sachs) I have a few questions. First, your peers said they will keep more GP for the next cycle. What are your thoughts on this? Second, how is digibank in Indonesia doing given that many banks there are also in digital banking? Finally, some housekeeping questions. On the sensitivity to interest rates, is it $2 billion for a 100 basis point increase in NIM or in interest rates? And how significant are Finnovation's risk-weighted assets?

Piyush Gupta We've built a lot of GP overlays, and like our competitors we certainly don't plan to release all of them because it's prudent to be adequately provided for the future. But there are two or three takeaways. First, our portfolio is in good shape. Our moratorium loans are down to 0.5% of our book, which is much smaller than our competitors. We don't have exposures in Malaysia and South-east Asia, so our position in that sense is a little different. Second, we've taken all of our GP through the P&L. We are not allocating CET-1 to RLAR, whereas our competitors are doing so. Nevertheless, we have the same mindset in being prudent in terms of releases.

On digibank, we have pivoted to better-quality customers. The competition is both there and not there. While several have made announcements about what they want to do, they are not yet in the market in a material way in terms of scaling up activity. Our customer journeys are quite good, but we've also deliberately slowed growth because of the environment. We've not wanted to push the asset book in Indonesia in the past 12 months.

The $2 billion sensitivity is related to 100 basis points of interest rates. Finnovation has almost no risk-weighted assets right now.

Nicholas Teh (Credit Suisse) In terms of the high-quality liquid assets with MAS, just wanted to check that these are yielding about 50 basis points. How big is that portfolio?

Piyush Gupta It is 50-55 basis points and $25 billion-30 billion.

Nicholas Teh Does the $2 billion sensitivity assume any increase in the loan-deposit ratio or is it based on the existing balance sheet? If you do switch some of the high-quality liquid assets into loans, is there upside?

Piyush Gupta Yes, it assumes a constant balance sheet. There is upside if we can deploy the excess liquidity into loans.

Harsh Modi (JP Morgan) A few questions. First, does the comment that negative jaws will narrow mean that we will still get negative jaws in 2022 or was that not the intention?

Piyush Gupta That was the intention based on a couple of assumptions. First, Treasury Markets trading reverts to a normal year of $1 billion in revenue, compared to $1.4 billion-1.5 billion this year. Second, I have assumed that there'll be no interest rate hikes next year. So if both these things happen, I give up some revenues on trading, I don't get rate hikes, and I want to make the investments that I spoke about, then you could get negative jaws. If markets are kind or rate increases come in, then we won't have negative jaws.

Harsh Modi This is even though current curve expectations are for two or two-and-a-half rate hikes in back half of 2022?

Piyush Gupta Correct, we've not factored them in.

Harsh Modi Is the reason for separating the digital assets a business imperative or to unlock capital?

Piyush Gupta It has nothing to do with releasing capital, since we have enough capital as you know. Any capital needed by the businesses can be allocated from the bank. There are two imperatives for separating the digital assets.

For some of the businesses, there are two ways to get customer growth since our existing DBS customer base is limited – it's about 10 million. The first way is B2C, which means you take the business directly to the market, which incurs high acquisition costs and cash burn. Given that we are publicly listed rather than privately funded, there's a limit on how much we can burn. The second way is B2B2C, going through intermediaries which value our capabilities and are quite happy to offer those capabilities to their customers. To gain customer access this way, it is much better for the business not to be embedded inside DBS but be a standalone entity that is free to create different partnerships with different counterparties. This scaling of our capabilities is the business imperative for separating the digital assets.

The second imperative is visibility. I pointed out before that one of my frustrations over the years is that we don't get the same value for businesses inside the bank that businesses exactly the same outside have. So the hope is that as we demonstrate superior capabilities that have a pathway to grow, we get more visibility. I will raise capital not because I am short but to demonstrate the value of the business.

Harsh Modi If you are not able to get the Citi assets you are looking at, is there a reasonable commitment to go quickly to 13% CET-1 quickly?

Piyush Gupta Yes, even if we get some of the Citi assets, we would still have excess capital and we can still go reasonably quickly to that range.

Harsh Modi DBS has become the only bank in the Governing Council of Hedera Hashgraph. This is quite cutting edge in terms of sort of blockchain. What does it bring to you as a bank? Is it one of the moonshots you are taking? Are you looking at becoming much bigger player in the DeFi space?

Piyush Gupta I started looking at Hashgraph two to three years ago when they first came to me. One of the challenges with crypto, and Bitcoin in particular, is that it's very hard to scale because the mining capacity and the latency needed for each transaction is extraordinarily high. So using blockchain to make a payment of $5 does not work because of the cost of settlement and the number of hours needed. Over time, alternative ways and better protocols will be needed for proof of ownership and so on. Ethereum is doing a whole lot of such roll-out but I think the Hedera foundation is another very viable way to do this.

This goes back to a question in the media session on our view on DeFi. While it’s not entirely clear what the long-term impact of DeFi is for banks, we have to adapt and be nimble. That means being in the flow, knowing the protocols we can use, how we drive the creation of some of the protocols, how we create smart contracts – these things can be hugely beneficial. This is one of the reasons for Partior. I think that the settlement system is ripe for change. Partior can do that, give us understanding and a foot at the door. Hashgraph and the Hedera foundation are the same thing, to get us a foot at the door, be part of the conversation and be able to learn and influence.

Yeoh Hong Nam Thank you, everyone. See you next quarter.