DBS
Live more, Bank less

Edited transcript of DBS first-quarter 2021 results conference call for buy and sell sides, 30 April 2021

Yeoh Hong Nam Good morning everyone.

Akash Rawat (UBS) Your recent acquisitions and the plans for future expansion are strong strategic moves, but should investors expect refinements to the dividend policy to preserve capital?

Piyush Gupta CET-1 was 14.3% at the end of the first quarter and since then Shenzhen Rural Commercial Bank has had less than a 0.2 percentage points impact. So capital is more than sufficient even if we were to bid for part of Citibank's portfolio. Our high capital levels also mean that we have the capacity to return to our pre-Covid dividend.

Akash Rawat With regard to the Digital Exchange, what sort of income contribution do you expect this year and in the future? And how do you see the business developing?

Piyush Gupta Meaningful contributions are more likely to start from 2022 than 2021 and the ultimate size of the opportunity is difficult to dimension for now. We will have a better sense as we learn how to monetise the business, but it is clear that markets are changing and customers are doing more and more.

Our positioning as a bank with higher service standards than the big exchanges has called for a deliberate approach to opening the business. We currently have 120 clients and are thinking carefully on how to onboard the many more waiting in queue. Trading is currently restricted to Asian hours, but it is clear that serious traders want 24/7 access, so there will be a steady progression between now and the end of the year. Interest is high in the four cryptocurrencies that we trade so that is likely to pick up too.

Other exchanges interested in our digital custody services are also approaching us. We will be able to charge for the service but the process needs to be streamlined and automated. We will have to tread carefully here to avoid an operations nightmare.

Finally, we intend complete one or two small securities token offerings in the second quarter, based on fixed income or property, to test processes. This will help us learn and season our procedures before scaling up.

Akash Rawat What drove the $7 billion increase in credit RWA and the offsetting reduction in market risk?

Piyush Gupta Loans grew $12 billion so a $7 billion increase is consistent with our risk density of around 50%.

Chng Sok Hui MAS has approved a refinement in our market risk model that is more consistent with the way risk is managed in the dealing room. We have now moved to a duration-based method, which is more efficient than the maturity-based method we were previously using. The duration-based method allows us to bucket cashflows by their interest rate sensitivity rather than taking the entire NPV and slotting it at maturity.

Akash Rawat Do you expect to see RWA growth from credit migration during the rest of the year?

Piyush Gupta The trend is in the opposite direction. Portfolio quality is improving with more upgrades than downgrades in the first quarter. The majority of Singapore's moratoriums are behind us and although Hong Kong's will continue to 2022, there is unlikely to be material stress.

Chng Sok Hui The breakdown of the RWA growth is readily visible in our Pillar 3 disclosures. They show an increase from asset growth and foreign exchange movements that was moderated by improving asset quality.

Akash Rawat Could you please share some colour on which sectors drove the $12 billion of loan growth over the quarter?

Piyush Gupta Loan growth was broad-based. Reverse repo transactions providing liquidity to financial institutional counterparties accounted for $3 billion. We also had $4 billion of corporate loan growth to energy, financial institutions, real estate and TMT. Trade grew $2 billion from energy, metals and TMT. Housing loans grew $1 billion and there were $2 billion of wealth management loan growth.

Nicholas Teh (Credit Suisse) The GP reserve was around 0.7% of loans in 2019, before the pandemic. Could GP settle around that level towards the end of 2022?

Chng Sok Hui MAS expects us to hold GP reserves amounting to 1% of a qualifying base. The base excludes housing loans because they are fully secured, so that is one factor explaining your observation of GP reserves below 1% of loans.

The GP reserves don't follow a fixed percentage. Instead they comprise a modelled reserve and a management overlay if we feel that the models may not have adequately reflected all the risks from the pandemic. The overlay takes into account a variety of factors, such as the unemployment rate, and if conditions improve it could result in a GP write-back. Stress scenarios are always considered in the overlay.

Nicholas Teh Regarding the dividend, do you think you could return to 33 cents in a single step?

Piyush Gupta If MAS removes all restrictions on dividend payment then there is every likelihood we will return to pre-Covid levels immediately. But if MAS only allows us to return in a graduated way then we will have to follow those guidelines. So far, there has not been any indication from MAS about their plans.

Nick Lord (Morgan Stanley) Wealth management volumes were very strong in the first quarter. Did these activity levels hold up in April? Secondly, loan growth in the first quarter annualises to double digits, considerably higher than the mid-single digit guidance. How do you see the year progressing? Finally, could increased digitalisation from Covid lead you to lower your branch footprint?

Piyush Gupta Wealth management activity in the first quarter was very strong but we expect it to be more in line with previous quarters. However, activity can be expected to return if market levels hold or the uptrend the resumes.

Regarding loan growth, we should exclude the reverse repos from the forecast as those are opportunistic and harder to predict. That leaves us with $9 billion of growth in the first quarter, as opposed to $12 billion. Our corporate lending and trade pipelines are robust so the second quarter is safe on those two fronts. Wealth management loans are a function of the activity we just mentioned so if activity is not as strong then that loan book will be softer. Mortgages could also slow in the second half as customers have brought resale transactions forward to the first half. So excluding the reverse repos from the first quarter puts loan growth at 2%, which annualises to 8%. Allowing for some slowdown puts us at mid-to-high single digits.

Your third question was on the branch footprint. We have been transforming the nature of our branches and some have evolved to become digital self-service hubs rather than full-service branches. This has allowed us to reduce footprint by trimming branch size rather than the number of branches. That's important as we still want to maintain a presence in various parts of the city. We will also likely rationalise the LVB footprint in time. So when we talk about a 20% savings in commercial real estate it includes branches as well the headquarters.

Melissa Kuang (Goldman Sachs) Could you share any colour on the AUM flows into Singapore and DBS and where they are coming from? Secondly, there has been considerable activity in the 'pay-later' space. Is this something that DBS could launch ahead of virtual banks starting in Singapore? Finally, how capital efficient would it be for DBS to make an acquisition in the consumer space to enhance your digital ecosystem?

Piyush Gupta In the first quarter we had $1.2 billion of net new money originating from a variety of countries, including North Asia. The flows were steady and from the usual sources with no particularly large movements from Hong Kong or China.

The opportunity in pay-later schemes in Singapore are unlikely to be large. Singapore SMEs are well banked with adequate access to financing especially with the government support programmes. We gave out 20,000 new small merchant loans last year. The flip side of pay-later schemes is the possibility of social issues. Central banks monitor the regulated banking space closely, watching net credit creation and if it is being overextended. Pay-later allows people to circumvent these controls, and regulators are clearly not comfortable with that. So there is likely to be sharper oversight of the space.

Your final question was on capital efficiency and adding to the digital ecosystem. MAS regulations already allow us to deploy up to 10% of total capital outside our traditional business so we are not disadvantaged from that standpoint. The digital companies' advantage stems from their ability to source capital from private equity and other investors on terms that are not available to public companies such as us.

We already have small investments in ecosystems outside our core where we can add value, but these amount to only a few million dollars. There are some opportunities to expand beyond core banking but we are thoughtful to make sure they makes sense. Our entry point would be to provide infrastructure services and leverage our technology capabilities. The aim would be to access a broader revenue stream by playing to our strengths as opposed to entering completely new businesses that we don't understand.

Harsh Modi (JP Morgan) Taking both organic and inorganic growth into consideration and assuming the pre-pandemic 33 cent dividend, when do you think your CET-1 can return to the 12.5-13.5% operating range?

Piyush Gupta Capital accretes every quarter even with the dividend at 33 cents. This creates a cushion for inorganic opportunities as we have discussed, but if we don’t do any then we will have to start returning capital to get back to 12.5-13.5%.

Harsh Modi Operational risk and counterparty risk for the digital exchange and Partior could increase if their AUM grows. Does capital consumption for these businesses become meaningful if they achieve scale?

Piyush Gupta These businesses are not particularly capital consumptive. There is operational risk, but very little credit risk or market risk. We will certainly have to be tight on operational risk, but the capital requirements are not large.

Harsh Modi The $1 billion full-year total allowance guidance appears conservative after only $10 million the first quarter. How should we think about the remainder of the year?

Piyush Gupta Total allowances appear as if they could come in well below $1 billion, although the exact number is hard to forecast. There are three components to the number.

First are specific allowances. At this point in time we are not seeing anything pointing to a pickup in SP. In fact, the $200 million in first quarter was a return to pre-pandemic levels.

The second component is portfolio quality, referring to model-driven GP. Improvements here have been led by stronger company financials with improvements in a large shipyard company and in a major automotive company during the quarter. The strong economic bounce-back can be expected to flow through to corporate earnings and then on to the portfolio. We will continue to see reversals of model-driven GP if this continues. Repayments have also contributed to the write-back as some weaker names repaid loans or tapped the bond markets for funds.

The last component consists of the management overlay correcting for the model’s difficulty in estimating the impact of moratoriums. Assuming the moratoriums continue to taper through the course of the year and if asset quality continues to improve, the question will be how much the overlay can be reduced for the moratoriums that remain. We will consider this over the following quarters.

Harsh Modi What is Partior’s customer proposition for cross-border payments and how would you monetise that? What impact could this have on customers and your financials a couple of years down the line?

Piyush Gupta There will be a benefit to customers, but it is likely to be limited. Similarly the fee impact will also be limited as we already charge for cross-border payments and there is little scope to raise fees. Instead the platform could garner a lot of volume simply by being more efficient. That would lead to more revenue from FX, but that isn’t the principal driver.

The attraction of the infrastructure play is to think like Visa, MasterCard or Swift. The former two charge a small fee simply for providing the mechanism on which global settlement takes place in the card space. This earns them between $15 billion and $20 billion each for doing that and a little more. Being part of the infrastructure would allow us to charge a small facilitation fee per transaction. And at that point we would essentially gain more from the value of the platform than direct customer revenues.

The problem with the current infrastructure is that cross-border settlement can take up to two days as payments are passed from bank to bank. This creates massive inefficiencies as FX and security are real-time concerns. When we launched our DBS Remit platform we addressed this through bilateral relationships in countries that were important to our customers. Changing the hub-and-spoke nature of the model essentially allowed us to execute cross-border payments in seconds. We have since grown this into a business generating over $100 million a year.

Unfortunately, you can only take a bilateral arrangement so far. What the blockchain will allow us to do is democratise at scale for any counterparty in the world instead of limiting us to counterparties with whom we have an arrangement. This will allow anybody on the platform to settle securities, FX and actual payments in real time. That's a game changer and much better than the current infrastructure, including Swift’s.

The challenge for Partior will be to get people to embrace the concept and to use it, which is why it has been created as an open platform. The first factor in our favour is central bank support. MAS is a big proponent of the project and they are talking to other central banks to see how we can encourage the platform and make it generally available. The second factor is the rising interest in central bank digital currencies. We will ultimately need a mechanism to settle CBDC across borders, and this blockchain-driven platform might well be a good way to do that.

Anand Swaminathan (Bank of America) ROE appears to have increased even adjusting for interest rates and credit. Has ROE shifted structurally to a higher level?

Piyush Gupta Adjusting for the unusually low credit costs and exceptionally high trading income lowers ROE significantly. At the same time structural enhancements in transaction banking, treasury customer flows and wealth management can be expected to contribute a percentage point of ROE improvement over time.

The ROE was between 10.5% and 11% in 2013 and 2014, when interest rates were at similar levels. The structural improvements could move ROE above 11% or even to 11.5%, but it’s unlikely to reach 13% until interest rates go up again.

Anand Swaminathan How do you see expenses in the next few quarters?

Piyush Gupta There will be gains from a sizeable transformation programme we are running that includes distribution and further digitalization. But wage pressures are building and it is likely that we will have to increase wages and variable compensation this year. Expense growth can be kept to 3% to 4% over the 2019 level but the cost-income ratio is likely to creep up because income will be down from lower interest rates.

Weldon Sng (HSBC) What criteria do you apply for acquisitions? The Citi assets are retail compared to wealth for the ANZ acquisition and SME for the SZRCB stake.

Piyush Gupta There are two parts to the Citi assets, like ANZ's. The first is the Citigold business, which is similar to the ANZ wealth business. The other part is a fantastic card franchise, which is similar to ANZ in Taiwan and Indonesia.

Weldon Sng On the Partior platform, how scalable is it? How many banks are in the pipeline? Do you need regulatory approval to expand to other currencies?

Piyush Gupta I will ask Kwee Juan to elaborate since he has the details. Basically, we are not creating a new cryptocurrency. All we are doing is digitising money that has already been cleared. So the regulatory forbearance is much better than creating a new currency.

Han Kwee Juan The platform will have core settlement banks in addition to participant banks. We are talking to core settlement banks for add-on currencies such as the yen, euro and, if we can, the renminbi. These banks would be the important ones. And then participant banks would come in to clear their corporate and treasury payments. We are speaking to six to seven banks in total at the moment. The entity is not yet fully operational and there is already quite a bit of interest. We have been getting inquiries from banks that we didn't target initially. We had just been looking at banks that could provide flows to get the platform going.

Weldon Sng In Indonesia, there are digital players such as Bank Jago. What is the difference between digibank and these banks, and how can you be competitive?

Piyush Gupta In many cases, you won't see much of a difference. The customer experience is quite similar. But large markets do not have a winner-take-all with a dominant market share. There will be multiple providers who win share from the quality of their digital platform and the suite of services and products they offer. One thing we have been quite successful at is ecosystem partnerships with e-commerce and other companies that we can plug our platforms into. I think we will be a competitive player in the market together with Jago and others.

Robert Kong (Citi) What is the long-term strategy and structure of the India franchise? I guess you are moving towards a hybrid strategy with digibank and LVB, whose 600 branches seem a bit high. Second, on SZRCB, what kind of management control do you expect get as the largest shareholder? I know you are getting board representation. Will the stake benefit your growth in Hong Kong?

Piyush Gupta LVB and SZRCB represent a shift in our thinking that started a few years ago, which is that it is not easy to grow a digital-only strategy into profitability. While there is strong growth in customers and eyeballs, they come from people such as millennials seeking freebies but are not easy to monetise. We have been thoughtful about how much resources to keep pouring in. Unlike start-ups concerned with growth since they drive valuations, we are more focused on cashflow and profitability.

We now realise that adding a branch footprint to a digital platform results in much better performance. A physical presence provides brand recognition; people are more willing to accept us as a local bank. We get better-quality customers we can do a lot more with. In addition, LVB has a presence in five southern states, which are better performing and better linked into Singapore. It allows us to improve our skew to large corporates by getting a greater exposure to the higher-return SME and retail segments. It also improves our deposit base. All these things change the game.

But I don't think we need 600 branches. They include branches for rural areas that can be replaced by correspondent arrangements with other local banks. We are trying to concentrate on districts we can get value from. We will overlay digital, which will take a year because aligning the technology platform doesn't happen overnight. We will add to assets they have, including gold and other secured loans.

One of SZRCB's strengths is that the chairman, CEO and management team are very good. They have skin in the game. They run the place well. We really don't think we need to do a lot of interfering in day-to-day management. Obviously, we have board representation so we will keep an eye on risk and help out where needed.

The value we bring is in transforming SZRCB into a more international and digital bank. That's what they have reached out to us for, and that's what we will put our energies behind. A large part of the resourcing for and driving of these incremental capabilities will be come from our teams in Hong Kong and the rest of the GBA, where we have got a fairly large presence in Shenzhen and Guangzhou. But we don't think we need to get involved in running the core bank.

Robert Kong While I understand the phenomenal upside of Partior, do you expect it to have a material impact on your fee income in the foreseeable future?

Piyush Gupta Our transaction banking business has been growing strongly, including through the pandemic. It's not because we charge a higher fee, but because we get higher volumes from APIs connecting customers with our platforms. So I think we can scale up volumes on Partior. It's less clear to me whether we will be able to charge premium pricing, and we would have to test that in the market as it evolves.

Yeoh Hong Nam Thank you very much for joining us.