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Edited transcript of DBS fourth-quarter 2021 results conference call for buy and sell sides, 14 February 2022

Michael Sia Welcome to the session for the buy and sell sides. As you have just seen the media briefing we can go straight to Q&A.

Nicholas Teh (Credit Suisse) My first questions relate to current and savings accounts, or Casa. If interest rates return to pre-Covid levels, do you expect Casa to stay above pre-Covid levels of around 60%? And if you do, would that be due to a structural change in your deposit franchise over the last years? Finally, do you expect the cost-income ratio to head towards 40% if interest rates return to 2019 levels?

Piyush Gupta On Casa, we think that a large amount of liquidity will remain in the system even after the Fed starts tightening. The Fed's balance sheet is currently at USD 9 trillion and when we look at the last time they tried to reduce the balance sheet, they only got from $4.5 trillion to around $3.6 trillion. So we expect that a Fed tightening will moderate growth in money supply and align it more closely to GDP growth, but that there will nevertheless be a supportive environment for deposits.

Casa makes up 76% of our deposits, having grown $140 billion over 2020 and 2021. Our modelling assumes that about 25% of the growth will reprice or flow out, both in SGD as well as USD. But as much of the Casa growth was sticky in nature, coming from operating accounts and underlying transaction volume growth, while the Casa ratio won't stay at 76%, it's unlikely to go below 60% either.

On the cost-income ratio, the short answer is 'yes'. If you add between $3 billion and $4 billion of income to our numbers and keep the cost base roughly stable, the cost-income ratio will be below 40%.

Nicholas Teh Would you accelerate digital spending or anything else if there was such a large improvement in income?

Piyush Gupta We could increase hiring and step-up activity if we have a tailwind from interest rates, but in the big scheme of things we are talking about an incremental $50 million to $100 million, whereas the increase on the income side amounts to billions of dollars.

Akash Rawat (UBS) On the rate hike cycle, what is your base case? Do you think that the Fed will carry out the six or seven rate hikes that have been priced into the market?

Piyush Gupta I think we will have a much better sense by June because by then we will be able to observe inflation and get a sense for how persistent it is. In fact, I think inflation is not transitory and that it hasn't just been caused by supply chain disruptions. After all, global trade volume went up by 5% last year. The real shift has been from a dramatic growth in demand for goods relative to demand for services. The first question is whether the demand for goods reduces sharply this year. The second is whether commodity and energy prices remain elevated. The third is whether the wage inflation that we're seeing creep into our business and that of our clients persists.

If inflation comes down from 7% and we see it settle around 4% or 5% then interest rate increases will be more moderate. But if for whatever reason the inflation rate doesn't come down, then there is no choice. Former RBI governor Raghu Rajan said that if inflation is high, then no matter what its cause, the Central Bank must act. As of now my base case for the year is one rate hike a quarter.

Akash Rawat My next question is related to the increased dividend. From a capital perspective, there is no doubt that you are in a very comfortable position. But if credit costs normalise in FY23 and there is a change in the interest rate outlook to only three or four rate hikes, could you be stretched to pay this dividend?

Piyush Gupta If we get four rate hikes, that's worth about $2 billion of income to us. So, if we go back to a normalised cost of credit, on a net basis we would still be a billion dollars over where we are right now. Alternatively, fee income is $3.5 billion and has been growing at double digits so if we continue to grow at this pace, we'll get a $300 million to $400 million uplift. And 5% of loan growth will give us another $300 million. So even if credit costs normalise, this will be offset by the underlying growth in the business. Any rate hikes will be an extra boost.

Akash Rawat My last question is on the sensitivity to interest rates. You expect net interest income to change by $18 million to $20 million per basis point of USD interest rates. Would it be fair to say that if your Casa ratio continues to stay at 76%, the sensitivity might be higher than that?

Piyush Gupta You may be right. But as rates start going up, several things will happen quite quickly. First, people will start moving from Casa to fixed deposits. Second, you'll start seeing some Casa outflows as rates rise and the Fed reduces its securities purchases. While we may benefit even more from higher rates in the very short-term, this will not hold for long and we should revert towards the sensitivity we have modelled.

Melissa Kuang (Goldman Sachs) Thank you for taking my questions. My first is if the Fed hikes seven or eight times, do you think loan growth could slow and could credit costs rise? Secondly, what is the appropriate dividend payout ratio given the loan growth guidance?

Piyush Gupta Seven or eight rate hikes starting from zero will put interest rates between 1.75% and 2.00%, which is unlikely to put a dampener on companies' willingness to invest and grow. That level of rates takes us back to the summer of 2019 when there wasn't a disproportionate impact from rates. Thus, interest rates around 2% aren't really high enough to impact people's investment decisions.

In terms of credit quality, the portfolio to watch at that level of rates is the SME book. We might see some stress if a rise in interest rates to 2% coincides with wage pressures and an increasing cost of goods from inflation. Having said that, the SME sector in Asia has been surprisingly resilient over the last five years. A large part of our financing is secured but there has not even been a need to foreclose. We manage the portfolio very tightly, watching industries at risk and their supply chains. We're talking about sectors such as building and construction, retail, tourism, textile, garments. Our stress tests don't show any material cause for discomfort, but it is one part of the loan book that we might see stress in.

On dividends, we like to keep some dry powder in case opportunities such as Citi Taiwan or Shenzen Rural Commercial Bank arise. But I hasten to add that we will probably need a couple of years to consolidate what we've done so we are unlikely to add more right now. Our modelling

suggests we could take the payout ratio above 60% quite easily without constraining business growth.

Melissa Kuang Do you think you credit costs could normalise back up to around 20bp by 2023?

Piyush Gupta Melissa, the uncertainty is not the rate environment but China. Our portfolios are well-managed and they have avoided the problems in the real estate sector and supply chains. But between now and 2023, we have the party congress as well as continued lock downs due to Covid variants. We are also waiting for the border between China and Hong Kong to re-open. So we'll have to wait and see what headwinds come out of China and Greater China before making predictions about 2023.

Harsh Modi (JP Morgan) Does the S$NEER slope impact the SGD 18 million to 20 million sensitivity of NII to a basis point change in USD interest rates in any meaningful way?

Piyush Gupta The uncertainty centres around how SORA reacts. In the past, SOR was directly linked to exchange rate policy so the S$NEER slope made a material difference. But in the new SORA world it's not clear how SORA will be driven by the exchange rate. We have assumed a fairly conservative pass-through from USD to SGD rates as a base case. But if we are wrong and the pass-through is materially lower, in a tail scenario the NII sensitivity could be SGD 16 million per basis point of USD interest rates, instead of SGD 18 million.

Harsh Modi My second question is on non-interest income. The duration on the book appears to be around five years. How does a parallel shift of the interest rate curve impact non-interest income and potentially the balance sheet?

Piyush Gupta There is almost no impact. The bulk of our duration is in the three- to five-year bucket, but more importantly, a large part of our book is in accrual and hold to collect portfolios where the mark-to-market doesn't affect the P&L. It either goes on an accrual basis or to the OCI line. So if anything what we are thinking about is when we want to start building more duration in the book.

Chng Sok Hui Harsh, if you look at slide 24 of the CFO Media Deck, you can see SGD 50 billion of securities in the hold to collect portfolio that are not impacted by rate movements. We hold this portfolio for yield. There are SGD 35 billion of securities that are fair valued through other comprehensive income, with the bulk concentrated in the very short term.

Harsh Modi Thank you very much. Just a couple more questions. As we are expecting around four interest rate hikes this year, how are you changing your product strategy on both sides of the balance sheet?

Piyush Gupta If you look at our mortgage activity over the last quarters, more than 60% of new mortgages have floating as opposed to fixed rates. We basically changed our pricing to be more aggressive on floating rate loans than on fixed rate loans in anticipation of rate hikes. In fact, we have applied the same strategy across the board to incentivise floating rate loans.

On the funding side, we allowed fixed deposits to flow out over the last couple of years and more than replaced them with low-cost Casa. And as we're considerably over-funded, we haven't needed to raise long-term fixed money.

Harsh Modi Finally on the operational risk charge, is it fair to assume that the 0.4% points of CET-1 will be available for distribution when the multiplier is lifted?

Piyush Gupta The $930 million of incremental capital that has been set aside can't be put to work, so when the multiplier is lifted we can either use it to grow or to distribute. And as I have already said that we have too much capital for growth, it will be available for distribution.

Jayden Vantakaris (Macquarie) On the digital outage, what is the expected timeline of the independent review and what is your base case for when MAS could lift the Operational Risk Multiplier?

Piyush Gupta We have done two reviews and a third is underway. The first was by the vendor who owns the software – they sent an expert from the US who spent a month with us. The second was by Deloitte, who is a system integrator for the software. A third independent reviewer started work a couple of weeks ago and is likely to finish by May. But we don't have to wait for the third reviewer to finish and are already tightening things up in parallel. My sense is that we'll be able to demonstrate that we've fixed all the areas that need to be fixed by the third quarter. After that, it is at MAS's discretion to decide whether they are satisfied, whether they want us to do more or whether they want to take more time to reach a conclusion. For reference, they took 14 months to reverse the charge associated with the ATM outage in 2010. Although we'll be ready in six to nine months, it is ultimately up to MAS.

Jayden Vantakaris My next question is on NIM. MAS has sounded quite hawkish lately and they are obviously seeing inflation come through. When you say that your modelling is conservative, does that mean that the S$NEER slope is already embedded in the model or is it done differently?

Piyush Gupta We don't need to embed the slope in the model. Instead, we look at the pass-through from USD rates to SGD rates and the other currencies in our book. The pass-through for SGD can range from 40% to 80%, whereas for the USD book the pass-through is obviously 100%. Then there's the HKD Hibor book, which is material because our HKD Casa ratio is 78% – even higher than the group. Finally, we take a conservative baseline around the model.

Jayden Vantakaris Finally, may I ask how DBS sees succession at the management level, whether for the CEO position or otherwise?

Piyush Gupta Our succession planning is robust and we identified potential successors for me years ago. These successors are continuously developed through different rotations so we have a deep bench. Our senior team has also been stable over the years and functions solidly, so I don't expect any discontinuity. Having said that, Jamie Dimon has this never-ending 'five years in the future' forecast, Brian Moynihan has declared that he is going to work till 70 and James Gorman has just said he wants to work till 70. And as my board is in no hurry for me to leave, there is plenty of runway ahead. So there will be no imminent announcements.

Weldon Sng (HSBC) How should we think about the $1.5 billion of GP overlay in the context of the GP stack, and how much is likely to be written back in 2022 given that you are $400 million above MAS requirements?

Chng Sok Hui Our total GP stack is $3.9 billion. Of this, $1.5 billion is an overlay connected to Covid and the balance $2.4 billion just follows the normal methodology for setting aside GP. We have not released any overlays built up for COVID, so the $1.5 billion has not been touched. The $447 million of GP write-back this year were purely from the normal stack as loan portfolio quality improved, weaker cases migrated out, tenors shortened, and cases resolved.

Piyush Gupta I expect releases from the $2.4 billion normal stack to continue this year because we've been quite prudent, and because we continue to see improvement all around. Some names were downgraded for prudential reasons but they are now being upgraded as they are performing. So we should see releases from the normal stack this year. Beyond that, it depends on how SP performs.

We could release some of the overlays this year, though we are unlikely to release more than $200 million or $300 million. This would leave overlays that could be released next year. So although I don't intend to release the entire $1.5 billion, because we will always be prudent, there may be some releases this year and the next.

Chng Sok Hui Releasing the overlay is also guided by how borders re-open. We track factors such as stringency, airport arrivals and delinquencies after moratoriums are lifted.

Weldon Sng Thank you. My next question is on Treasury Markets income. How does the $1.1 billion of annual income that you expect appear in the income statement?

Piyush Gupta The $1.1 billion is a mix of interest income and net trading income that depends on the traders' strategy. Sometimes they take positions that contribute yield and spread to interest income, and sometimes they work through derivatives which contribute to trading income. I am not concerned which line they generate income in.

What is more important is how robust our performance was – we generated around $1.5 billion of income in each of the last two years. In 2020 we made money on the fixed income portfolio when interest rates collapsed, but 2021 has not been helped by that at all. Instead, we were very active across a whole range of other desks. We are relatively confident that we can average $275 million a quarter, or $1.1 billion a year. This assumes that the $1.5 billion in each of the last two years was on the high side and that $300 million or $400 million might not repeat.

Chng Sok Hui The $1.1 billion is the annually expected combined Treasury Markets income that is shown in the net interest income line, as well as the non-interest income line. This is disclosed in the segmental report on page 11 of the Performance Summary, where for 2021 the $1.5 billion earned comprises $783 million of net interest income and $726 million of other non-interest income.

Neel Sinha (CLSA) I have three questions. First, on the cost front, are there any fallbacks or clawbacks from your infrastructure service providers in relation to the digital disruption in November? Second, which sectors within the SMEs do you think are most likely to have a stress point, and how much exposure do you have to those segments? Finally, how do you see ESG in terms of

your asset base two to three years from now, and how does the bank look at its own carbon footprint and reduction targets over the next few years?

Piyush Gupta There is no clawback on the digital outage because the installation was in-sourced. We bought the access control technology from a US-based company which have some 1,500 clients worldwide and which is within the three top providers in the world. But we implemented and installed it ourselves. The technology passed the reviews – the fault tolerance of the system, the replication methodology and the redundancy all stacked up. So we do not anticipate any clawbacks.

Your second question was on SME. For the last four or five years we have been most careful around the construction, F&B, retail, tourism and tourism-related sectors. Over the last few years we've tightened our oversight of these sectors, exiting marginal names, improving our security positions, and doing everything that we needed to. So these portfolios are well-managed and we have not seen any pain over the last months. I thought we might see some pain after the moratoriums wound up, but we are now down to under 5% of the $7 billion of loans that were under moratorium at end-2020 and delinquencies have not moved up. We'll continue to look at the sectors but it looks okay from what I can see right now.

Finally, on the subject of sustainability. We are pushing the sustainability agenda actively. We grew sustainability-linked loans by $20 billion in 2021 on top of the $10 billion the year before that. So we are on track to exceed our of sustainability finance target of $50 billion by 2024. We were also very active in the capital markets last year, with 40 sustainable or green DCM deals worth $23 billion. The sustainable and green financing segment continues to grow disproportionately quickly.

Three months ago, we signed the Net-Zero Banking Alliance commitment letter, pledging to achieve net-zero carbon emissions by 2050. I held off for almost a year because I wanted to make sure that this wasn't an aspirational 30-year promise that somebody after me will have to worry about. Instead, we did a lot of work to make sure we knew what the milestones along the way are. Today we are measuring carbon emissions of about 3,000 borrowers, making up a third of our book and are working with consultants to model the rest. We've also published a transition finance taxonomy laying out what qualifies as sustainable and what doesn't. We're currently working actively with our clients to determine acceptable transition pathways for different sectors. We have a very good line of sight over what is needed between now and 2030 to set ourselves on the path to meet our net-zero commitment.

On our own footprint, we said our operations would be carbon neutral by the end of this year. Our buildings in Changi use our own solar power, generated by solar panels we installed on them. We've retrofitted some of our buildings like the one in Newton to be completely carbon neutral. We've changed the entire fleet for our cash-in-transit and for servicing our ATM from fossil fuel to electric vehicles. And we've dialled down our use of paper. But even after doing all that, we rely on the electricity grid in Singapore so we have an active programme of carbon offsets to make up the difference. This will bring our carbon footprint to zero by the end of this year.

Michael Sia Thank you for joining us. We'll see you next quarter.