FITCH RATINGS: DEUTSCHE BANK'S RATING WILL DEPEND ON EXECUTION OF RESTRUCTURING

Fitch Ratings-Frankfurt/London-08 July 2019: The direction of Deutsche Bank's 'BBB' rating will depend on how the bank progresses with its restructuring plan, Fitch Ratings says. The plan shows management's determination to strengthen the bank's business model and address its key weaknesses.

Cutting back volatile, capital-intensive and underperforming sales and trading activities, and further reducing the cost base should improve profitability and strengthen leverage, but execution risks are high. The Outlook is Evolving, indicating that the rating could move in either direction over a one-to-two-year horizon.

Management now targets a return on tangible equity of 8% by 2022 (after additional Tier 1 coupons), compared with just -0.1% in 2018. This looks comparable with the weighted average annualised return on equity achieved by banks in the EBA's risk dashboard in recent quarters (around 7%).

When resolving the Evolving Outlook, we will assess how resilient Deutsche Bank's core businesses are to the planned business closures, staff reductions and cost cuts. Management's ability to manage capital and liquidity through the restructuring is also important for the rating.

Deutsche Bank could be upgraded if it makes significant progress in refocusing on activities with a better risk/return profile and capital usage, primarily by reducing volatile and underperforming investment banking. The rating could also benefit if Deutsche Bank can generate stronger returns from its core commercial banking, private banking, asset management and smaller investment banking businesses, and to contain and reduce losses associated with the restructuring.

Deutsche Bank will create a capital release unit (CRU) to facilitate its exit from equity sales and trading, and reduce its activities in lower-returning rates and credit derivatives, residual non-strategic derivatives and securitised bonds. The CRU will entail high up-front restructuring-related costs, peaking this year. It will house EUR74 billion of risk-weighted assets (RWAs) and EUR288 billion of leverage exposure, equivalent to 21% of the bank's corresponding totals at end-1Q19. Most of the credit/market-risk RWAs and the leverage exposure should run down quickly over 18 months.

However, Deutsche Bank's investment bank will remain large after the planned CRU reduction, consuming about 38% of the group's RWAs in 2022 (excluding operational RWAs but including the residual CRU). Improving the investment bank's core returns (only 2% return on tangible equity in 2018, based on pro-forma disclosures) will therefore be important for reaching overall performance targets.

Execution risk is material for the rating. The restructuring measures involve large staff cuts and significant leadership changes, which could disrupt the aim to improve core earnings. The economic slowdown could also hamper revenue growth.

Deutsche Bank does not plan a capital increase. Restructuring costs and upcoming regulatory capital headwinds will have to be buffered by existing capital and the capital release from the CRU. The bank has lowered its targeted common equity Tier 1 ratio floor to 12.5% from 13% but this is still commensurate with its rating given the planned changes to its risk profile. However, a sharper or sustained deterioration threatening to breach regulatory requirements could trigger a downgrade.

The CRU exits should improve the bank's leverage ratio (end-1Q19: 3.9%), which lags peers. Deutsche Bank now targets a ratio of 5% by 2022. This is broadly in line with the weighted average ratio of banks in the EBA's 1Q19 risk dashboard (5.2%).

Deutsche Bank plans to manage its liquidity and funding metrics well above regulatory requirements. A weakening of the liquidity profile, through wholesale deposit outflows or a decreasing liquidity coverage ratio could put pressure on the rating. The bank expects its regulatory liquidity funding and net stable funding ratios to improve to 146% and 125%, respectively, at end-2019. They are likely to decrease in the longer term but should continue to provide ample headroom over the required 100%. The bank also expects a more stable and less costly funding mix, with lower reliance on trading and other wholesale funding sources.

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