S&P Global
Ratings

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Research Update:

Deutsche Bank Outlook Revised To Positive On Improving Resilience; Ratings Affirmed And “May-Pay” Notes Upgraded

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PRIMARY CREDIT ANALYST

Giles Edwards
London
+ 44 20 7176 7014
giles.edwards
@spglobal.com

SECONDARY CONTACT

Harm Semder
Frankfurt
+ 49 693 399 9158
harm.semder
@spglobal.com

Overview

- We expect Deutsche Bank to emerge from this deep, but short-term, cyclical downturn with a resilient balance sheet.
- Management has continued to demonstrate robust execution of the deep phase of operational restructuring that it started in 2019.
- We are revising the outlook on the bank and its core operating subsidiaries in Europe and the U.S. to positive from negative and affirming our 'BBB+/A-2' issuer credit ratings.
- The positive outlook anticipates that the benefits of restructuring will emerge over the next 12-24 months and, if substantially realised, would yield business stability and lift Deutsche Bank's performance more into line with higher rated European peers.

Rating Action

On Feb. 26, 2021, S&P Global Ratings revised to positive from negative its outlook on Deutsche Bank AG and its core subsidiaries. At the same time, we affirmed the long- and short-term issuer credit ratings at 'BBB+/A-2'. We also affirmed our resolution counterparty ratings on Deutsche Bank and its core subsidiaries and the 'trAAA/A-1+' Turkish national scale issuer credit ratings on Deutsche Bank.

We also raised our issue ratings on Deutsche Bank's additional tier 1 hybrid instruments to 'BB-' from 'B+' and on the Deutsche Bank Capital Trust I TRUPs to 'BB' from 'BB-'. We also affirmed our issue ratings on the bank's senior subordinated and subordinated debt.

Rationale

Our base case for Deutsche Bank since April 2020 has centered on two key expectations: it would emerge from this deep, but short-term, cyclical downturn with a resilient balance sheet; and it would clearly benefit from a more efficient, focused, and well-controlled business and operating model. We see this second element as critical to allow management to deliver its targeted 8% return on total equity (ROTE) by 2022. Most importantly, it will also enable the bank to achieve the operating and franchise stability and the sustainable, predictable performance that it has lacked since 2014.

Deutsche Bank's financial performance in 2020 exceeded our cautious expectations. Buoyant capital markets activity and strong client demand for risk management solutions supported the bank's revenue base, offsetting margin pressure in its retail and corporate banking businesses. This allowed the bank to report a pretax profit of €1.0 billion and net profit of €0.6 billion, despite the material step-up in credit loss provisions (CLPs) and ongoing cost drag from restructuring and the exit of legacy positions managed by the Capital Release Unit. Most importantly, management appears to have delivered robustly on the operational restructuring, hitting its cost and other targets.

As expected, throughout the year Deutsche Bank maintained sound capital, liquidity, and bail-in buffers. We had expected that the bank's common equity tier 1 (CET1) regulatory capitalization would fall meaningfully below 13.0% in 2020, that its S&P Global Ratings' risk-adjusted capital (RAC) ratio would fall toward 8.0%, and that the bank's additional loss-absorbing capacity (ALAC) ratio would fall close to 9.5%. The bank's 13.6% CET1 ratio at end-2020 will reduce close to 13.0% by end-2021, still comfortably above management's 12.5% floor. However, we are more confident that the bank's RAC ratio will operate in the 8.0%-8.5% range through end-2022, and that its ALAC buffer will hover around 10.0%, so continuing to support the existing ALAC uplift to the issuer credit rating.

We see management as having established strong credibility in its delivery of the operational restructuring. Now more than half-way through the restructuring that started in 2018 and accelerated in mid-2019, management has so far delivered on all its cost-focused financial targets. With 85% of the transformation now completed, the financial benefits of these actions will now start to emerge more visibly in 2021 and more so in 2022 as restructuring costs fall away and the steady run rate cost savings take further hold. This will drive down adjusted costs toward management's €16.7 billion target for 2022, and narrow the gap between adjusted and reported costs. While beyond the 2022 horizon, the ending of bank levies in 2024 will save the bank a further €0.5 billion per year. We also see a gradual improvement in the bank's previously checkered risk and control track record over the past two years, with far fewer material litigation and regulatory investigations still open.

Nevertheless, we remain cautious about the profitability outlook for 2021 and 2022. Consistent with our unchanged view of a negative trend for economic risk in Germany and many other major European economies, we remain highly mindful of downside risks from the COVID-19 pandemic. To achieve the 8% ROTE target, management plans to replicate 2020 revenues in 2022, but we still see this as highly challenging given 2020 outperformance in the investment bank and the continued difficult revenue environment for retail and corporate banking. We see this as the greatest challenge. Furthermore, while CLPs will very likely have eased by 2022 from the elevated €1.8 billion charge of 2020, the pandemic legacy for borrower asset quality remains hard to predict.

We anticipate that Deutsche Bank will maintain sustainably higher capital headroom over regulatory minima. As a result, we have upgraded the bank's may-pay capital instruments as we see lower attendant coupon nonpayment risk. At end-2020 and pro forma for January 2021 capital issuance, the bank's lowest headroom over its MDA thresholds was 3.1% from 1.6% in March 2020. This stemmed in part from the Spring 2020 easing in regulatory requirements, some of which is temporary but much of which is permanent. Even once the bank's CET1 regulatory ratio reduces to a little below 13.0%, we expect it will maintain a minimum MDA headroom of around 200 basis points (bps). Our decision also reflects restructuring progress that we expect to reduce the risk of unexpected losses and the bank's steady accumulation of tier 2 capital. We note also that the bank's improved leverage over the past offers substantial headroom over the leverage MDA requirement that will start to take effect later in 2021.

Outlook

The positive outlook reflects our view that in the next 12-24 months it will become clear whether management will succeed in substantially delivering the financial targets that would place Deutsche Bank's performance more squarely among that of its European peers at the low 'A'/high 'BBB' rating level. However, we acknowledge that the main performance uplift will come only in 2022, and that the weak operating conditions could squeeze revenues (relative to 2020) and asset quality metrics more than management expects, particularly if economic recovery is significantly delayed. Our base case also assumes the maintenance of sound capital and liquidity buffers, in line with management guidance.

Upside scenario

We would likely raise our long-term issuer credit rating if we have greater confidence that the final phase of strategic execution of the restructuring plan will deliver much stronger profitability from 2022, close to management's targeted 8% return on total equity. It would also be supported by easing residual downside risks, notably on asset quality, from the COVID-19 pandemic.

We would reflect this improvement through the removal of the ICR adjustment notch as the bank's creditworthiness would have improved relative to stronger peers. This would benefit our issuer credit ratings on the bank's rated European and U.S. operating companies, and related senior preferred debt. We are unlikely to revise upward the group's 'bbb' stand-alone credit profile in this 12-24 month timeframe. As a result, there is, for now, remote upside to our issue credit ratings on the bank's senior nonpreferred debt and hybrid capital instruments.

Downside scenario

We could revise the outlook to stable if we see a more material setback to profitability and asset quality that is likely to prevent management from bringing profitability close to its 2022 target. Delayed economic recovery could yet slow the emergence of fruits of the restructuring and reopen doubts about the bank's capacity to return to sustainably stronger earnings.

Ratings Score Snapshot

	To	From
Issuer Credit Rating	BBB+/Positive/A-2	BBB+/Negative/A-2
Group SACP	bbb	bbb
Anchor	bbb+	bbb+
Business Position	Adequate (0)	Adequate (0)
Capital and Earnings	Adequate (0)	Adequate (0)
Risk Position	Moderate (-1)	Moderate (-1)
Funding and	Average and	Average and
Liquidity	Adequate (0)	Adequate (0)
Support	(+2)	(+2)
ALAC Support	(+2)	(+2)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(0)	(0)
Additional Factors	(-1)	(-1)

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Financial Institutions | General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- Criteria | Financial Institutions | Banks: Assessing Bank Branch Creditworthiness, Oct. 14, 2013
- Criteria | Financial Institutions | Banks: Quantitative Metrics For Rating Banks Globally: Methodology And Assumptions, July 17, 2013
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Bulletin: Deutsche Bank Reports Solid 2020 Results, Feb. 4, 2021
- Capital Resilience Alone Won't Stabilize European Bank Ratings In 2021, Feb. 3, 2021
- Bulletin: Deutsche Bank Reports Good Restructuring Progress, Dec. 9, 2020
- Deutsche Bank AG, July 16, 2020
- Negative Rating Actions Taken On Multiple German Banks On Deepening COVID-19 Downside Risks, April 23, 2020

Ratings List

Outlook Action; Ratings Affirmed		
	To	**From**
Deutsche Bank AG		
Deutsche Bank Trust Corp.		
Deutsche Bank Trust Co. Delaware		
Deutsche Bank Trust Co. Americas		
Deutsche Bank National Trust Co.		
Deutsche Bank Luxembourg S.A.		
Deutsche Bank AG (Milan Branch)		
Deutsche Bank AG (Madrid Branch)		
Deutsche Bank AG (London Branch)		
Deutsche Bank AG (Cayman Islands Branch)		
Deutsche Bank AG (Canada Branch)		
Issuer Credit Rating	BBB+/Positive/A-2	BBB+/Negative/A-2
Deutsche Bank Securities Inc.		
Issuer Credit Rating		
Local Currency	BBB+/Positive/A-2	BBB+/Negative/A-2
Upgraded		
	To	**From**
Deutsche Bank AG		
Junior Subordinated	BB-	B+
Deutsche Bank Capital Finance Trust I		
Preferred Stock	BB	BB-
Ratings Affirmed		
Deutsche Bank AG		
Issuer Credit Rating		
Turkey National Scale	trAAA/--/trA-1+	

Certificate Of Deposit	
Foreign Currency	BBB+/A-2
Deutsche Bank AG	
Deutsche Bank Luxembourg S.A.	
Deutsche Bank AG (Milan Branch)	
Deutsche Bank AG (Madrid Branch)	
Deutsche Bank AG (London Branch)	
Deutsche Bank AG (Cayman Islands Branch)	
Deutsche Bank AG (Canada Branch)	
Resolution Counterparty Rating	A-/--/A-2
Deutsche Bank National Trust Co.	
Deutsche Bank Trust Co. Delaware	
Deutsche Bank Trust Co. Americas	
Resolution Counterparty Rating	BBB+/--/A-2
Deutsche Bank Securities Inc.	
Resolution Counterparty Rating	
Local Currency	BBB+/--/A-2
Deutsche Bank AG	
Senior Unsecured	BBB+
Senior Subordinated	BBB-
Subordinated	BB+
Subordinated	BB+p
Certificate Of Deposit	A-2
Certificate Of Deposit	BBB+
Commercial Paper	A-2
Deutsche Bank AG (London Branch)	
Resolution Counterparty Liability	A-
Senior Unsecured	BBB+
Senior Unsecured	BBB+p
Senior Subordinated	BBB-
Deutsche Bank AG (New York branch)	
Senior Unsecured	BBB+
Senior Subordinated	BBB-
Subordinated	BB+
Deutsche Bank AG (Sydney Branch)	
Senior Subordinated	BBB-

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. A description of each of

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