S&P Global
Ratings

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Research Update:

Deutsche Bank Ratings Affirmed As Profitability Creeps Upward; Key Challenges Remain

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Overview

- Deutsche Bank has seen mixed progress in its mission to significantly enhance its profitability. Execution on reducing costs and refocusing the business has been solid, but revenue has been weaker than expected.
- Although significant execution risks remain, we are affirming our 'BBB+'/'A-2' issuer credit ratings on Deutsche Bank and its core operating subsidiaries.
- The stable outlook acknowledges the ongoing revenue challenges inherent in Deutsche Bank's restructuring, but reflects our view that the management team will continue to deliver fully on the initiatives within its control, and that key clients will remain engaged.

Rating Action

On May 24, 2019, S&P Global Ratings affirmed its long-term and short-term issuer credit ratings on Deutsche Bank AG and its core subsidiaries at 'BBB+'/A-2'. We also affirmed our resolution counterparty ratings on these entities. The outlook remains stable.

At the same time, we affirmed our issue credit ratings on all of Deutsche Bank's hybrids instrument, including our 'BBB-' rating on the bank's senior subordinated debt and our 'trAAA/A-1+' Turkish national scale issuer credit ratings on Deutsche Bank AG.

Rationale

We affirmed our ratings on Deutsche Bank because we consider that management has built credibility through the execution of its operational and financial objectives, and this has delivered some early progress in the goal of significantly enhancing the bank's profitability. Following management's April 2019 decision to end merger talks with Commerzbank, we look for further evidence that the bank's stand-alone strategy is being well executed and that, in time, the bank will be able to adequately cover its cost of capital, aided by an improved base of more-stable revenues.

We remain acutely aware that significant challenges remain. Specifically, Deutsche Bank suffers from continued weak revenue, structurally higher funding costs than peers', and the negative effect on its franchise of years of restructuring and sometimes unhelpful news flows. Although we see Deutsche Bank's improved distribution capacity as helpful for the bank's may-pay hybrids, given the bank's still-weak capacity to absorb unexpected losses through earnings, we do not yet perceive meaningfully reduced coupon nonpayment risks for these instruments.

Group credit profile

In our view, in the year since the refreshed management team launched its updated strategy, it has established its ability to execute. After a rapid adjustment to the Corporate & Investment Bank (CIB) division, management achieved its 2018 cost target and had the confidence to slightly toughen the 2019 target of €21.8 billion of adjusted costs.

That said, despite some signs of revenue growth in areas like transaction banking, the broader revenue environment continues to test Deutsche Bank. The slowdown in the domestic and European economies has been bigger than expected; equity and capital markets remain lackluster; and the ultra-low interest rates and stiff competition have persisted. This burden also weighs on many of Deutsche Bank's European and other competitors, but falls particularly heavily on Deutsche Bank given its very low current profitability.

Although management has felt able to restate its target of a 4% return on tangible equity (ROTE) for the 2019 financial year, consensus estimates currently envisage an outcome nearer 2%. We consider this level conservative, if management delivers fully on its initiatives. If the bank does underperform against its aspirational 4% target, we would see a qualitative difference between the possible underlying reasons. Market weakness is cyclical and would affect peers as well, but factors linked to cost control and market share and franchise erosion could imply a failure to lift the structural earnings capacity of the group.

In stating that it continues to review all alternatives to improve long-term profitability, management has acknowledged that it may need to take further strategic actions to achieve its longer-term financial targets. In our view, the bank will remain under strain until it starts to close in on this objective. We would evaluate any further announcements as they arise.

Management's bid to build credibility has not only centered on financial performance, but also on its desire to demonstrate continued balance sheet strength, and improved control. This would give confidence that the bank is escaping its somewhat accident-prone track record. We continue to see the balance sheet as solid, with the Common Equity Tier 1 (CET1) ratio likely to remain comfortably above 13% (as management intends) and the S&P Global Ratings risk-adjusted capital ratio likely to be 8.5%-9.5% range (which we consider adequate). We note management's ongoing program to redeploy some of the excess liquidity into assets that do not lead to a negative earnings drag, and expect that this will be executed cautiously.

On controls, compared with previous years, the bank faces much-reduced contingent liabilities from litigation: the U.S. Department of Justice investigation into the Russian mirror trades is the most important unresolved case, in our view. Although not easy for the market to discern, management reports improved regulatory comfort with its efforts to strengthen the control environment, whether in financial crime controls, management information, or data modeling. We expect the market will continue to focus primarily on financial performance, but an absence of risk-related events would, in our view, help to break the feedback loop of weak sentiment toward the bank.

Hybrids

In February 2016, we lowered the ratings on the Tier 1 and perpetual Tier 2 capital instruments by one notch due to constrained available distributable items (ADIs). For Tier 1 issues, interest cancellation is compulsory if, among other circumstances, aggregate interest payments on these instruments in a financial year exceed adjusted ADIs on an unconsolidated basis under German generally accepted accounting principles (GAAP). This relatively narrow definition resulted in a lower level of ADIs than in the bank's consolidated International Financial Reporting Standards (IFRS) accounts. We saw Deutsche Bank's ADIs as more restricted than most peers' because they are more narrowly defined, and so applied an additional one-notch negative modifier to our issue ratings on these instruments.

In recent months, two legal developments have, in our view, materially improved the bank's distribution capacity. The first is the creation of an additional €2 billion of general reserves under German GAAP following the completion of the Postbank/PGK legal entity merger. The second is the imminent revision to the EU capital requirements regulation, due to take effect in the coming weeks, which will enable all EU banks to use IFRS reserves as the basis of their ADI calculation. As a result, we see Deutsche Bank's coupon-paying capacity as much improved.

However, EU banks also face acute (though not automatic) coupon nonpayment risk if they breach their capital requirements--defined as the sum of the Pillar 1 and Pillar 2 requirements plus combined buffers--known as the MDA (minimum distributable amount) thresholds. In 2019, the phase-in of these buffers has reduced the headroom above the MDA. For Deutsche Bank, the MDA thresholds in 2019 are CET1 of 11.8%, Tier 1 of 13.3%, and total capital of 15.3%, against which it reported ratios of 13.7%, 15.9%, and 17.7%. We regard Deutsche Bank's 1.9% headroom on the CET1 requirement as notable. Although it is not unusual among European peers, we see the bank's capital ratios as potentially more volatile than peers' due to its currently limited loss-absorbing capacity through earnings--a vulnerability identified in the 2018 European Banking Authority stress test of the sector. We consider it unlikely that the bank will significantly improve the MDA headroom, and so expect to continue to constrain the issue credit ratings on these instruments until its earnings capacity improves meaningfully.

Outlook

The stable outlook acknowledges the ongoing revenue challenges inherent in Deutsche Bank's restructuring, but reflects our view that the management team will continue to deliver on the initiatives within its control, and that key clients and stakeholders will remain engaged and supportive. This will help the bank to steadily deliver more solid and sustainable returns. We will continue to observe how the execution of this strategy unfolds and, market cyclicality aside, whether Deutsche Bank materially improves its earning generation capacity. While the full effect of the restructuring will likely not play out until at least 2021, though end-2020 we look in particular for robust delivery against management's cost targets, as well as for a meaningful improvement in reported ROTE over the period.

Downside scenario

We could lower our long-term issuer credit rating on Deutsche Bank and its core subsidiaries if we see material setbacks in the delivery of the updated strategy or signs of a stalled improvement in profitability, for example, if the investment banking franchise erodes further. This would be more likely in the event of management missteps, but could result from a sustained adverse environment that severely pressures group revenue. A lower rating would be consistent with a view that, notwithstanding Deutsche Bank's position as a leading European bank, the business stability that comes with an end to restructuring and delivery of satisfactory financial performance is likely to remain elusive, and also that its franchise and competitive position would have further weakened.

In this scenario, we would very likely revise down the 'bbb' stand-alone credit profile (SACP), and so lower our issue credit ratings on all rated debt, including the senior subordinated debt and regulatory capital instruments.

Upside scenario

An upgrade is unlikely in the coming 18 months because the unsupportive market environment is already undermining progress in improving group ROTE, and so delaying the benefits of strategic execution. We would therefore likely see improved performance through 2020 as positive steps in the bank's journey, rather than its conclusion.

We could upgrade the bank once we gain greater confidence in Deutsche Bank's execution, such that it appears likely to achieve a more stable and predictable business model. This would narrow the gap between Deutsche Bank and its global peers, in terms of revenue generation and cost control. We would likely make this revision by removing the notch of adjustment to the issuer credit rating. It would therefore affect only the senior (preferred) debt, not our ratings on the senior subordinated debt and regulatory capital instruments.

Ratings Score Snapshot

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

Related Criteria

- 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: Bank Hybrid Capital And Nondeferrable Subordinated Debt Methodology And Assumptions, Jan. 29, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- General Criteria: Group Rating Methodology, Nov. 19, 2013
- 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: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Deutsche Bank Long-Term Rating Lowered To 'BBB+' On Elevated Strategy Execution Risks; Outlook Stable, Jun. 1, 2019
- Europe's Banks Must Step Up To Crack Down On Financial Crime, April 18, 2019
- Commerzbank And Deutsche Bank Potential Merger Holds Promise Of Increased Efficiencies But Also Risks, March 18, 2019
- ECB's Fresh Stimulus Spotlights Rising Risks For European Banks, March 8, 2019
- The Top Trends Shaping Major European Banks In 2019, Feb. 28, 2019
- Deutsche Bank AG, Dec. 21, 2018
- European Bank M&A: More Talk Than Action, Aug. 6, 2018
- Bulletin: As Commerzbank And Deutsche Bank Talks End, What Now For The Two Banks?, April 26, 2018

Ratings List

Ratings Affirmed

Deutsche Bank AG	
Issuer Credit Rating	BBB+/Stable/A-2
Turkey National Scale	trAAA/--/trA-1+
Certificate Of Deposit	BBB+/A-2
Deutsche Bank AG (Canada Branch)	
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)	
Issuer Credit Rating	BBB+/Stable/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.	
Issuer Credit Rating	BBB+/Stable/A-2
Resolution Counterparty Rating	BBB+/--/A-2
Deutsche Bank AG	
Senior Unsecured	BBB+
Senior Subordinated	BBB-
Subordinated	BB+
Subordinated	BB+p
Junior Subordinated	B+
Certificate Of Deposit	A-2
Certificate Of Deposit	BBB+

Ratings Affirmed	
Commercial Paper	A-2
Deutsche Bank AG (Cayman Islands Branch)	
Commercial Paper	A-2
Deutsche Bank AG (London Branch)	
Senior Unsecured	BBB+p
Senior Subordinated	BBB-
Deutsche Bank AG (New York branch)	
Senior Subordinated	BBB-
Subordinated	BB+
Deutsche Bank AG (Hong Kong Branch)	
Deutsche Bank AG (Singapore Branch)	
Deutsche Bank AG (Sydney Branch)	
Senior Subordinated	BBB-
Deutsche Bank Capital Finance Trust I	
Preferred Stock	BB-
Deutsche Bank Contingent Capital Trust II	
Deutsche Bank Contingent Capital Trust III	
Deutsche Bank Contingent Capital Trust V	
Preferred Stock	B+

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. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.