



# **DB – BoAML Annual Financials CEO Conference**

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## Q&A

**Andy Stimpson (Bank of America Merrill Lynch):** Good morning everyone. Thank you for joining us again on the second morning. I'm very pleased to see that Deutsche Bank's CFO, James von Moltke, is joining us again this year. Welcome back. Similar to many other sessions, we're going to run this as a fireside chat but I will allow time for questions from the floor. And as always, you can type them in and I'll try and collate and bundle them together into the iPad here. So thank you for coming back for a second time.

**James von Moltke (Deutsche Bank):** A pleasure to be here.

**Andy:** Maybe to start off, I think markets are starting to think, well, maybe we're late cycle or coming towards the end of the cycle. You're one of the, well, I wouldn't say few banks – you're one of the banks which is still in restructuring mode. How do you view the risks around still being in restructuring mode if we are going to reach late cycle?

**James von Moltke:** Sure. Thank you, Andy. And pleasure to be here for the second year. So my own opinion – everybody has a view as we just saw about the economy. My own opinion is the market is getting a little bit ahead of itself in terms of concerns around the next downturn. I think there are good reasons to think that if and when a downturn comes, it may be relatively modest given the strength generally of the financial services industry, the impact of post-crisis regulation and what have you.

But again, the market is anticipating things that are probably two and maybe more years out. You have robust growth in a number of regions of the world particularly the US. Global growth economists estimate to be 3.8% this year which is reasonably strong and perhaps slow a little into '19. So it's overall a reasonably strong macroeconomic backdrop for the industry.

There are obviously geopolitical things going on that cause people to have some worry. But our own view is that they're not going to materialise into larger disruptions. And so we're focused on really a steady-as-she-goes sort of scenario.

To one of the questions that just came up and we may talk about it but certainly we'd like to see this growth continue, like to see some more inflation that would allow the central banks to begin to tighten or normalise interest rates which I think would be healthy both for the financial services world and for the economies in general.

To your question about our bank and how we're prepared for it. To begin with, we run a very conservative balance sheet. So from a capital and a liquidity perspective, we feel that we're running at a level that prepares us very well. Our risk appetite is also in my judgment conservative. And you see that playing out in our numbers whether it's the VaR that we publish or our credit losses, admittedly in a relatively benign environment, but we're underwriting to standards that we think will protect us in a potential downturn.

Where we obviously have some work to do – and this is our focus – particularly as we manage the bank through the next several quarters and couple of years - is expanding our operating margin. You know, part of the resilience of a financial institution lies in its ability to earn money, and for earnings to generate capital and also dampen the impact of a weaker environment. That's where our focus is. It's on managing revenues up and costs down and so expand our margin and therefore our resilience.

But one other thing I'd say and this is what you hear a lot from the capital-markets-oriented banks: for us, an environment with a little bit more uncertainty frankly is good both in our markets businesses but also in other businesses as long as it's in a range that doesn't affect corporate confidence. We feel like a little uncertainty is actually good for our business model.

**Andy:** Okay. And how has corporate confidence been affected so far? Have you seen much effects yet?

**James von Moltke:** Not a great deal. I mean you do talk when you're meeting with clients and hearing about discussions in the board rooms obviously about the trade discussions that are going on. But I think people understand and certainly the economists are doing their job putting the newer trade tariffs into context - so what is the likely effect on growth of those tariffs and they're relatively small.

If it continues for a considerable amount of time there will be discussions that need to be had about supply chains, about the way that economies are structured. But I think that's a long way down the line. And again, that itself can result in some degree of corporate transactions, financing needs, restructuring requirements which fit with our business model.

**Andy:** Sure, okay. And you made a point before on interest rates. I think that it's fair to say that the rate rise cycle in Europe has taken longer than what the market thought it would be 18 months ago. How much, you know, and we're starting to see some pressure from the roll off of hedges there, how much more pressure is there to come from the roll off of hedges and how are you - are you still hedging your deposits today or actually increasing the leverage for when do rates go up?

**James von Moltke:** Sure. Well, obviously, and hence I was interested in the questions or the answers about the rate cycle. Clearly, we are geared to increasing rates. And that's true of any bank but I think more in our particular construction than others. And I think it would be, I guess I said earlier, healthy for the economy and for the financial sector to see a rate rise cycle in Europe. I do remember that the US had a series of years in which the forward curves weren't met and then finally the lift came. And one would hope that a similar pattern will come in Europe in time.

As I say, we're idiosyncratically, I think, more adversely affected than some in part because we're in Germany, in part because we have a lower loan-to-deposit ratio than some of our peers, in part because we're more institutional than some of our peers. And then frankly, we're positioned to be short. We simply don't want to carry the risk in OCI of a significant long investment in rates at this point in the cycle, which I think is again also conservative in terms of how the balance sheet is structured. So all of that results in us being relatively geared to rising rates.

Part of your question was how do we feel about the deposit hedging and the lingering effect of declining rates. As we've said before, we see ourselves at the tail end of that cycle. It's not over in terms of year-on-year impact from interest rates, hedges rolling off, the very long dated hedges from the past. But we're towards the end of that cycle. We would expect over the next couple of years that it will level out.

And then what matters is frankly, to my earlier point, the reinvestment rate. We do still hedge our deposits in the businesses but the overall balance sheet is positioned very short.

**Andy:** Okay, thank you. You've got both a retail and a CIB business. Can banks, you know, still be leaders – can you still be a leader in both of those segments given the heavy investments that are needed in both business, I think?

**James von Moltke:** I think the answer is yes. I mean, there's some evidence in the world that that is a model that works. And frankly, there's good reason for it to work in terms of how today, G-SIB balance sheets fit together from a liquidity and capital perspective, the mix of risk intensity and leverage exposures. You know, there's good ways in which retail-oriented and wholesale-oriented balance sheet fits together. So we're a strong believer in that model.

In our case, as you mentioned there, there is significant investment need in our businesses across the waterfront. And so as a consequence, one of the things you see in our current earnings profile is a, in some ways, a catch-up need in investment. And you're right that we're having to invest in, I'd say three areas in the main. Retail obviously some degree of investment in our institutional businesses but then also regulatory remediation.

So there's some element of a wave of investment going on. We think we have the scale to be able to invest in those businesses. But frankly, we want to see the pay off from those investments flow through earnings in the years to come.

Part of our strategic goal as we announced earlier this year is to shape the businesses, rebalance towards what we see as the most stable businesses. So that will inform obviously some of our investment and also capital allocation decisions. But on the whole, yes, there is an investment demand going on.

One area that we talk about as an example is our retail businesses internationally where we have made an investment decision in Spain and Italy. And I talked in June that we're about halfway through an investment cycle there. That's in total about €300 million that we've put to work. It should begin after 2020, into 2021 to really drive returns in those businesses but that's one of many investments that we're having to make and sustain.

**Andy:** And are those – a lot of those investments then are on the technology side.

**James von Moltke:** They are generally on the technology side. So technology is a big area of our investment but not exclusively. They also go to some degree of restructuring or refinement of our distribution model, working hard on the balance of products and client selection in those businesses. So it goes beyond that but naturally technology is a reasonably large component of it.

**Andy:** Okay. And I'm just taking some questions from the iPad here, you've been, you know, certainly the former CEO was quite vocal on technology and there was a heavy, you know, we can see there's a heavy CAPEX cycle which – I think last year it reduced very slightly. We'll see what happens this year. Where are you in that cycle of upgrading the technology? Are we nearly there yet or is it – is there a long way to go here?

**James von Moltke:** I wouldn't say nearly. I mean, there is still work to do. But I don't think of it – people like to think it's a start, middle, finish in a kind of universal context. That's just not how it is. You have projects that come up. They roll on and they roll off and they're replaced by other projects.

I'm not an economist but I think economists sometimes talk about the lump of work. The way I think about technology is essentially, we have a certain amount of resources that we can deploy every year in technology investments. And internally then through an investment governance process, projects compete for those resources. We have to prioritise but the goal is to get things through that chain and derive benefits then from completed investment projects.

I don't anticipate that it ends. But it's certainly, I mean, it should crest. And over time as investment needs for example in regulatory remediation begin to abate, that should free up then resources for additional investment.

**Andy:** Yeah. And where are we on that regulatory cycle because it feels – it means a lot to us in the room, more at the, you know, we've got the Basel finalisation. That was a big event for all of us but some of the banks allude to, you know, all sorts of changes on the cybersecurity, regulatory side and there's more operational regulation which doesn't pump out a ratio for us in the room. Where are we in that cycle, I guess it will never be done but in the bulk of that work?

**James von Moltke:** I would characterise it as light at the end of the tunnel. There have been – and we called this out earlier this year – there have been remarkably large projects that have needed to go – needed to go through the US expression as the pig and the python. They were significant technology and also operational efforts. MiFID II was one. PSD2 was one. Brexit preparation is a significant, again, technology build.

And then regulatory remediation, whether that's in controls, in KYC capabilities and what have you, that's ongoing. But over the next couple of years, I certainly see that again, cresting and us deriving some of the benefits in terms of efficiency and effectiveness of our capabilities there so progress.

**Andy:** Okay. And so does that mean as that spending comes down, does all of that get reinvested into more kind of business development, more interesting projects to develop the business going forward or did the costs actually come down because, you know, IT costs actually did – actually have started to come down at least in the second quarter, even a bit last year if we adjust for the amortisation of all the prior CAPEX. So I guess the worry is for any bank where costs are coming down, is there enough left over for investment to get ready for the future?

**James von Moltke:** Yeah. So as I think about it, just to frame it a little bit, what we report as IT expenses. We are running somewhere around 900 million to 1 billion a quarter so in round numbers, about 4 billion a year. That's identified IT expenses. There's also some amount of internal IT expense that isn't capitalised in terms of personnel expenses. So when you sometimes hear us talk about 5 billion, what you see in the financial statements is four, the difference is that that sort of internal spend on technology.

But if you think about the four, basically we're working to hold it reasonably leveled which means to your point that we do have to absorb some degree of amortisation. There's an amortisation ladder that we've worked through over the past several years. And it will continue for more as we capitalise more development. That does tend to squeeze out a little bit of new development but it's in that process where we work to, again, prioritise and also

improve the efficiency of technology delivery. I think you've heard me say that before as well.

So in principle, you know, working to manage to the extent that we can to a relatively leveled extent of investment, prioritise within that investment, absorb the amortisation ladder. To your point though, in a declining – overall declining expense picture - it means that the amount of expenditure on technology-related things as a percentage of the whole expense base will naturally increase.

**Andy:** And how much of that overall number for the IT budget, how much at the minute is going on what we'd all probably agree is innovation?

**James von Moltke:** You know, innovation is really hard to identify.

**Andy:** It's a buzzword.

**James von Moltke:** I know. It's a wonderful buzzword. And frankly, you know, it absorbs a lot of management tension in terms of how you manage innovation. But if you think about trying to go through all of the budgets, all of the projects that make up that 4 billion and identify which you'd characterise as innovation and which are whatever, maintenance, it's hard to do with any sort of meaningful definition or comparable definition.

What I would say is we are focused on preserving a sufficient amount of budget in that prioritisation effort, in that overall spend to ensure that we're remaining on a competitive, if not, cutting-edge level in terms of – and what you would think of as innovation spend. And that may be apps in retail. It may be releases of APIs in the institutional business. It may be supporting sort of new technology, new product capabilities in our transaction bank, things like that that I would certainly look at as innovation. But it is a focus in our management discussions, in our investment governance prioritisation to ensure that we preserve enough resource for innovation while we deal with deferred maintenance, production support and necessary investments in areas like reg remediation.

**Andy:** Okay. I'll ask one more on the technology side then see if we got any live questions. But, you know, I'll get all my buzzwords out the way early. Working with fintechs, I've seen you – you've actually purchased, you bought, you acquired some fintech companies. Other banks are using more accelerators. Other banks aren't even doing that. They just want to, you know, use the fintechs and be the customer of the fintech. How are you working with the fintechs? Are you, you know, where are you in the mentality of, you know, giving up some of what Deutsche Bank does or used to do and just giving it to the fintechs?

**James von Moltke:** Yes. Well, I'd bridle against the language of giving it to the fintechs because naturally we need to defend our business. And the things that we see as being our unique value proposition, what drives something special about our institution. But to your question, it's really an all-of-the-above answer. So we, again, not to spread ourselves too thinly, we try to manage this so that we are effective in the deployment of our resources. But we do have labs and if you like accelerator environments. We have innovation going on in the businesses. We work with fintechs. In many instances, we integrate fintech capabilities into our offerings which we've done visibly in some of our retail capabilities where – and we'll even use the external brand inside our platforms.

And then we will make either investments in a minority stake to get access to the technologies or in a couple of instances, we've in fact bought in companies in order to bring the technology into the company. So it's an all-of-the-above, way of thinking about it. But we try to be targeted on those things where we think we add specific value where we see perhaps gaps in our capabilities so that we're not spreading ourselves and our resources too broadly.

**Andy:** Okay, great. Have we got any live questions from the floor? Yeah, down the – the home team. We got microphones. Grab a mic from the back.

**Speaker:** So yesterday in the Italian press, there was an entertaining article about merging with Commerzbank. I actually don't want you to comment on that neither do I want you to comment on the suggestion that you'd need to raise 13 billion in order to do this. What I would like you to comment on was the perception the article had that you needed that level of 13 billion or more to cover derivatives exposures.

**James von Moltke:** Thank you for not asking me to comment on things I can't comment on.

**Andy:** I'll do it next so...

**James von Moltke:** I have to say these days, we're constantly amazed at what passes through the editorial filters and gets into the press. And that bears no relation to our public reporting or anything in the real world that we can point to so very little I can comment on in terms of the fictions.

**Speaker:** So forgetting those parts but there is a bit of an ECB thing at present which you could argue was started by the Italian authorities as a distraction to their own problems about level two and level three assets. And I think Mr Draghi put this in one of his speeches last week. So there is a thing that – it's become decided, you know, ten years on that somehow people with a lot of mark-to-model assets, there's a risk in that. So could you comment – is that something you're experiencing? It's a discussion they're having at a high level. So that's not specifically for Deutsche Bank but clearly people, including Deutsche Bank, you have significant mark-to-model assets on the balance sheet. Thank you.

**James von Moltke:** Sure. Well, look, this debate is one of the reasons that if in our second quarter results, we tried to offer some more or if you like some distilled disclosure about those positions for us. I definitely would not deny the theme that you're referring to. And – but it's dialogue that we're engaged in with the regulators and the accounting professionals, what have you just so that these things are fully understood.

I do think the equivalence between 22 billion of level three assets on our balance sheet and the entire non-performing exposures in Italy is not a meaningful equivalence. They're very different – different activities, different types of banking exposure. We're very comfortable with our accounting for and our observability metrics and the way we look at levelling and hedging and managing our level three portfolios. That's the message we tried to give in the second quarter.

We think it's a natural part of our business model frankly of intermediating risk. Some of that risk shows up on our balance sheet either for a long time or temporarily. And some of it based on an accounting definition of observability will end up seen as a level three asset. But

it's something we manage very carefully and hedge in the derivative exposures and we're very comfortable with.

**Andy:** Yeah. And then I'll ask a couple from the iPad.

**Speaker:** Not living in Germany, my impression is that the spreads and margins because of all those savings banks are extraordinarily low. And about 18 years ago, this is the – we were going through the same comment and today, we're still here. Is there any observable improvement in the spreads that you make that would give a positive impact over time to your bank on a fundamental basis or is it too small to be talked about?

**James von Moltke:** There's been some increase. First of all, there is loan growth in Germany. So the German retail market and to some degree the commercial market has been growing. Historically and absolutely, the structure of the market is challenging for the private banks given that we can compete with savings banks and cooperative banks. And that hasn't changed and we don't anticipate that changing in the future.

But one does see some slow evolution, if you like, on the asset side of the balance sheet. There is more consumer unsecured coming out. There are some models out there that – in the fintech world that generate those types of exposures. Generally speaking, we're cautious about how much of that, if you like, consumer unsecured that we put on. We need to make sure it fits within our underwriting standards. And so we might participate to a lesser extent than perhaps others.

I will say though that we can't sit and bemoan the fact that we're a German bank. What we need to do is create a model with the resources that we have to have a better than its cost of capital performance in our retail and commercial bank in Germany. We think we have the wherewithal to do that and hence the Postbank merger with our retail and commercial, with the Deutsche Bank branded retail and commercial bank. At our scale, our product capabilities and with the synergies that we believe we can extract from that merger, we think that our model becomes better than its cost of capital over the years to come. And that's regardless of the spread environment that you refer to in Germany.

**Andy:** I think maybe I'll follow up on that. Can you – there's a few questions here on, I guess we're coming around to an M&A style question. I was trying to circle around it for a bit. Can you update us on where we are with the Postbank merger? And ultimately, I guess we're trying to wonder there whether there's any upside to do another, you know, layer on another integration on top of that given all press rumours? But maybe if to start, would you comment on Postbank first?

**James von Moltke:** I maintain the discipline of never commenting on M&A as a former M&A banker. Look, we're pretty clear in our public statements that we've got a lot of work to do. And the Postbank merger is a big element of that. It's a large and complicated merger. And so while we are making progress, we're looking to accelerate the progress where we can.

The stage we're at now is having completed the legal merger in the second quarter. We're working now on the head office integration. After the head office integration we will turn our focus to the technology end and broader integration of the two banks. It's a process that will take several years. And while we'd, as I say, we'd love to accelerate as much as you can off that, it just takes that careful integration in the environment that we're in, in Germany, in



bringing these two banks together successfully and sustainably. So progress, perhaps slower than we'd like but we're working diligently to execute on the merger and crystallise the synergy benefits.

**Andy:** And is the – let's say you had much higher revenues, would that allow you to accelerate that process? Is it a profitability constraint or is it just more operational risk?

**James von Moltke:** No. It's a lump of work constraint.

**Andy:** Got it.

**James von Moltke:** We just have a lot to work through.

**Andy:** Got it. Now, if I switch to the CIB. I will ask about the third quarter eventually.

**James von Moltke:** Sure.

**Andy:** Leave it a bit longer.

**James von Moltke:** Tantalising.

**Andy:** It builds the suspense in the room. Revenues, I guess, the trend we've been seeing is that revenues have been falling for the industry but for Deutsche Bank more so. When are we going to see the – those revenues stop falling? Have they already stopped falling? And you can break that down by products if you want or overall.

**James von Moltke:** If you talk about the big picture, the industry wallet pools that you see, you saw a trend over several years of declining wallets. And those trends seem to have slowed and in some cases improved. I think the equity wallet improved last year and they've been moving around at levels that I think at least demonstrates some stability in the global industry wallet which I think is encouraging.

The industry has been going through some amount of change through that time. For us, clearly we've gone through a series of restructuring steps. And our focus now is on bringing stability to the bank to focus on the perimeter or the clients, the product capabilities that we have and build from that foundation in terms of stability and future growth in revenues. That is very much our focus every day.

**Andy:** Okay. And at 2Q, you said, you know, leverage ratio has gone up. And do you think the 4% leverage ratio, that's enough of a platform to be able to go out and say that you can grow from there because obviously if you grow, then it would start coming down again?

**James von Moltke:** We do. Look, we made enormous progress in the second quarter in terms of leverage exposure. And part of that is business selection, client selection. Part of that is better efficiency in terms of the usage of leverage exposure on the balance sheet.

As I said in July, we're comfortable with the current ratio and level of leverage exposures. So we expect to manage broadly at the level that we go to in June and maybe increase over the years to come. But there is still opportunity, I think, to drive some efficiencies so reinvesting, if you like, leverage exposure improvement that come from run-off of old portfolios or efficiency that we create in areas like netting.

To your question about the ratio, we're very comfortable. We are consistent in our messaging about the ratio. It was 4.2% at the end of the second quarter. This is on a phase-in ratio.

But in terms of our target of building over time to 4.5%, we view ourselves very much to be on track.

And going to the earlier point about model, I didn't get too deeply into the model risk versus leverage exposure debate. But our balance sheet isn't exactly comparable to the balance sheets of some of our peers in terms of the risk content in our leverage exposure. And so we feel very strongly about that. And if you look at the balance sheet and do the comparisons it jumps out.

**Andy:** And is there the ability to take that risk higher or is that – because your CET1 minimum, you've got lots of – you've got high CET1 to risk-weighted assets ratio but the minimum is quite high as well?

**James von Moltke:** I think so. At this point, I would view us as being steady in both measures, leverage and risk-weighted assets at least for a period of time. Over a longer period of time, naturally there will be some shifts – growth as we build capital and some degree of change in the relationship between risk content or RWA and leverage exposure if for no other reason the RWA inflation that will over time come in through FRTB and other elements of the final Basel III framework.

**Andy:** Okay. If you think about the footprint of the IB, you've been pulling back a bit in the US. You know, the US is by far the most profitable investment – CIB market out there. How do you view that strategically given that if you're going to be lighter in the bit that's most profitable, does that leave you exposed in the other markets over time?

**James von Moltke:** So one thing I do want to emphasise and we do whenever we can that the press and others did the best they could to garble our messages. But we've been very consistent. We are absolutely committed to CIB, to the investment banking business. It's our DNA and there's no change in our view there. And as a subset of that committed to the US market because as you say, to be a global investment bank while with deep European roots and frankly a unique strategic position in my judgment in the Eurozone in terms of the breadth of capabilities we have and the global reach, you absolutely have to be present in the United States.

And as you pointed out, it's the deepest capital market and the deepest revenue pool. But we've chosen to be more selective in what we pursue with the United States. A recognition that we could not compete across the broad range of activities in the US with our US peers for whom it's a domestic market but we absolutely feel it's a critical part of being a global investment bank or a European investment bank with global reach.

**Andy:** Okay, great. Before the iPad blows up, I'll ask you about the third quarter. Have you got any comments around how things are going and what the peers have said?

**James von Moltke:** Sure. We look at consensus which we publish on our website. And I'd say we're broadly comfortable with the consensus IBIT, pre-tax profit, on a reported basis. There naturally will be some swings and roundabouts and of course the quarter isn't over. If I think of kind of variances to that picture, we think that – relative to current consensus - the adjusted cost number is likely to round down to 5.5 billion rather than round up. Our focus remains very much on delivering against our commitments which is a 23 billion adjusted cost base in 2018. So that's one difference.

You'd see some offset frankly from lower non-operating expenses relative to consensus. And the one other thing I'd point out, again, in terms of differences to consensus – consensus really bakes in DVA impact. It's hard to measure for analysts. But this quarter, you've seen some spread tightening which is good. It shows increasing confidence in our credit. But that of course has a DVA impact.

**Andy:** Okay. And anything on the market?

**James von Moltke:** Not really much to offer. And one point that we made last quarter is we sort of want to go away from the perennial game of guessing how quarters are going to be in the global markets business. We're going to focus on executing our strategy, delivering our commitments.

**Andy:** I did try. Everyone can stop yelling at me on the iPad now. Another question which is coming quite a lot on the iPad is Brexit and how Deutsche is preparing for Brexit and how you see the costs of preparing for that and the developments there.

**James von Moltke:** Sure. Again, another thing that got a little bit garbled in the press, there's been no real change in our Brexit preparation path. We're different to many of our peers because we're an EU bank with the global capabilities we have. And so we are working towards the rebooking of a large portion of the balance sheet that today – for our global markets business - today is booked in the London branch, to the head office - same legal entity. But from a systems and a regulatory reporting perspective, there's a change.

We're executing that. We're on track. We're beginning the client repapering effort and have made sure that in the context of our plans, we have the flexibility to be prepared for an unexpectedly fast Brexit. And that's been pretty consistently our path.

The other thing that we, consistent with the guidance from the UK regulators, have been working towards is the recognition of our branch status in the UK. And so while it would be smaller than it is today, we would still intend to operate in a branch in the UK. And again, there's been no change in our plans there. It's something we've been working on now for some considerable time.

**Andy:** Sure. I think I've got time for one last literal question. There's a couple of questions here on credit ratings. And is there any level at which the credit rating starts to impact the real business?

**James von Moltke:** Sure. And I'd say at the margin, it does today. We're pleased that we finally have the clarity of the final German bail-in law which allowed us to issue senior preferred credit or senior preferred debt. That came into effect in July. We issued our first senior preferred bond. Moody's has helpfully clarified that our senior unsecured rating is at A3. And so I think that is a more normal picture than we've had since 2017 when the initial bail-in law was promulgated. So that is progress.

Our senior non-preferred ratings clearly are not where we'd like them to be. And over time a funding disadvantage in that non-preferred unsecured creeps into your funding costs and so this absolutely is an area of focus because we clearly need to price transactions at a slightly higher cost of funding. And we'd like to mitigate that and be competitive across the board.

**Andy:** Okay, great. I would leave it there. 15 seconds to go. That's my best time management ever. Thank you very much, James.

**James von Moltke:** Thank you, Andy.

**Andy:** And thank you everyone for your questions. Thank you.

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