FitchRatings

Fitch Downgrades Deutsche Bank to 'BBB'; Outlook Evolving

Fitch Ratings-Paris/London-07 June 2019: Fitch Ratings has downgraded Deutsche Bank AG's (Deutsche Bank) Long-Term Issuer Default Rating (IDR) to 'BBB', Viability Rating (VR) to 'bbb' and Derivative Counterparty Rating (DCR) to 'BBB+(dcr)'. Fitch has also affirmed the bank's Short-Term IDR at 'F2'. The Outlook on the Long-Term IDR is Evolving.

A full list of rating actions on the bank and its rated subsidiaries is available at the end of this rating action commentary.

The downgrade of Deutsche Bank reflects its continued difficulty and limited progress in improving its profitability and stabilising its business model. Unlike other rated global peers, Deutsche Bank's retail franchise and pricing power in its home German market are not strong enough to mitigate this.

The Evolving Outlook reflects Fitch's expectation that ratings could over time benefit if the bank takes measures to strengthen its business model. On the other hand, failure to address the bank's weaknesses could put further pressure on ratings.

Management has indicated its willingness to make 'tough cutbacks' and tighten its strategic focus on the better performing businesses in the corporate and investment bank (CIB), accelerate the private and commercial bank's (PCB) business integration and maintain cost discipline. If implemented effectively and in a timely manner, such actions could ultimately allow the bank to stabilise its business model and generate acceptable returns. This could lead over time to a positive rating action. However, we believe that a further restructuring would be difficult to implement. Failure to deliver a business mix with more adequate returns and strengthened ability to generate capital internally could lead to a further downgrade of the ratings.

KEY RATING DRIVERS
IDRS, VR, AND SENIOR NON-PREFERRED DEBT RATINGS
DEUTSCHE BANK
Deutsche Bank's IDRs and VR reflect the bank's wide-ranging challenges and protracted progress in restoring adequate and sustainable returns. The high reliance on, but insufficient earnings from, the capital markets businesses, negatively influences our assessment of the bank's company profile, strategy and profitability. The bank's good capitalisation, funding, liquidity and asset quality underpin the ratings.

Management remains committed to its global and CIB-heavy business model, although over time favouring retail, asset management, transaction banking and a CIB division refocused around its stronger business lines could improve the bank's earnings and stability. Statements made at this year's annual shareholder meeting suggest further business scope adjustments in CIB. These could support the ratings if the adjustments have a meaningful impact on earnings prospects and risk appetite, and if management contains the franchise damage potentially resulting from restructuring measures.

Deutsche Bank has underperformed earnings expectations raised at the 2018 strategic review and, absent an external or one-off boost, we expect the bank to miss its return on tangible equity (RoTE) target of 4% in 2019.

Revenue weakened in 4Q18 and 1Q19 in a difficult environment for its market-driven businesses, and due to the impact of disposals and lack of progress with restoring its lost franchise. Global growth slowdown and the lower likelihood that rates in Europe will rise in the near term also moved against Deutsche Bank, making its longer term RoTE target of 10% unattainable, in our view.

Cost reduction appears to be on track toward the initial adjusted cost target of EUR22 billion we identified as a VR sensitivity during our last review. The bank's now slightly lower target of EUR21.8 billion for 2019 would represent a cost reduction of EUR1 billion yoy. We view this target as achievable but still insufficient to address the bank's weakening revenue and lagging efficiency relative to its peers.

Despite Deutsche Bank's modest earnings, we expect its fully loaded CET1 ratio to remain above management's 13% target and above the bank's regulatory requirements and Pillar 2 guidance. The CET1 ratio of 13.7% at end-1Q19 provides some headroom to absorb about 40bp regulatory impact expected over the next two quarters, and further flexibility can be gained through disposals in risk-weighted asset (RWA)-heavy businesses. However, improving the bank's ability to manage capital and absorb the impact of new regulations, including the final Basel III rules, is contingent on an increase in internal capital generation.

The bank's fully loaded leverage ratio of 3.9% at end-1Q19 is at the lower end of its European peer group and falls short of the bank's 4.5% medium-term target. The bank is principally managing the ratio by reducing leverage exposure, as evidenced by a EUR100 billion reduction in CIB in 2018.

Deutsche Bank's funding is more confidence-sensitive than peers' given the bank's weaker credit profile and significant share of wholesale funding. About half of its external funding of about EUR1 trillion at end-2018 consisted of retail and transaction banking deposits, which were well in excess of loans, and the merger with Postbank has improved the fungibility of funding in the group. Long-term senior and subordinated debt also provides stable, albeit more expensive, funding. Less stable sources of funding (banks, unsecured wholesale, trading liabilities, repos and securities loaned, brokerage and securities payables, net derivatives) represent around one third of total funding. Although sizeable, a significant share of these is client-driven and matched with assets.

The bank's liquidity position remains comfortable, and we expect it to remain managed significantly above regulatory requirements, despite a planned reduction. The bank reduced its EUR260 billion liquidity portfolio by about EUR20 billion over the 12 months to end-1Q19. This was part of a liquidity redeployment programme that includes an absolute reduction and some reallocation from cash (which is loss-making in the negative interest rate environment) to higher-yielding liquid and business assets. The bank also plans to reduce its debt issuance in 2019 to manage its funding costs by deploying some excess liquidity.

Deutsche Bank's progress to improve risk controls, in particular with respect to updating and improving the bank's IT infrastructure, automating processes and strengthening anti-money-laundering and know-your-customer controls has been protracted and the bank, in our opinion, still lags its peers. Deutsche Bank's contained appetite for credit and market risk and retreat from business areas the bank views as more vulnerable are important mitigating factors.

Underpinned by sound underwriting standards, Deutsche Bank's credit risk exposure entails a high proportion of investment-grade counterparties and resilient German commercial and retail customers. We view the exposure to leveraged finance, commercial real estate and emerging markets as the bank's main vulnerabilities in a downturn. The downsizing of non-strategic CIB assets and underperforming shipping exposures has resulted in credit risk reduction over the last years.

We have affirmed the bank's Short-Term IDR at 'F2', which is the higher of the two ratings mapping to the bank Long-Term IDR of 'BBB' according to Fitch's updated Short-Term Ratings Criteria. This level reflects a funding and liquidity profile that is a relative strength to the VR.

Consequently, the Short-Term IDR and the other short-term ratings of Deutsche Bank and its rated subsidiaries are no longer Under Criteria Observation, where they were placed on 7 May 2019 following Fitch's publication of its cross-sector criteria for Short-Term Ratings.

We have withdrawn the short-term senior non-preferred rating of the bank's US dollar debt issuance programme. This rating is no longer relevant for Fitch's coverage because debt issued with original maturities of less than one year has preferred status under the new German resolution regime.

DB PRIVAT- UND FIRMENKUNDENBANK AG (PFK)

The Long-Term IDR and senior non-preferred debt ratings of PFK are equalised with its VR. PFK shares a common VR with its parent Deutsche Bank as we believe the credit profiles of the two entities cannot be meaningfully disentangled. This reflects their high management and operational integration (including our expectation that capital and liquidity will remain fungible) and PFK's large size relative to its parent. In line with Deutsche Bank, PFK's Short-Term IDR is the higher of two levels that map to the bank's Long-Term IDR.

We have affirmed and withdrawn the ratings of PFK's commercial paper and senior unsecured debt issuance programmes. These ratings are no longer relevant for Fitch's coverage because these programmes are no longer used for new issuance and Fitch does not rate any outstanding issuance under the programmes.

DEUTSCHE BANK AG, LONDON BRANCH (DB - LONDON BRANCH), US AND AUSTRALIAN SUBSIDIARIES

The IDRs and debt ratings of DB - London branch and Deutsche Bank's US and Australian subsidiaries are equalised with Deutsche Bank's to reflect their high integration and core roles within the group, especially its capital markets activities, or their role as issuing vehicles.

DCR, DEPOSIT AND SENIOR PREFERRED DEBT RATINGS

Deutsche Bank's DCR, long-term deposit and senior preferred debt ratings and PFK's long-term deposit rating are one notch above the respective entities' Long-Term IDRs. This reflects the statutory preferential status of senior preferred and structured notes, deposits and derivatives in Germany and Deutsche Bank's large buffer of qualifying junior and senior non-preferred debt, which Fitch estimates at about 22% at end-1Q19.

DB - London branch's DCR and long-term deposit and senior preferred debt ratings benefit from the same one-notch uplift from the Long-Term IDR as we believe the insolvency hierarchy would be derived from the incorporation of the legal entity (Germany) rather than the branch's location (UK). However, we have not given any uplift to Deutsche Bank Securities, Inc.'s DCR over the entity's Long-Term IDR to reflect the absence of preferential treatment for derivative counterparties in the US.

The short-term deposit and, where applicable, senior preferred ratings of Deutsche Bank, PFK and DB - London branch are the lower of the two short-term ratings that map to their 'BBB+' long-term deposit and senior preferred ratings as the junior and senior non-preferred debt buffer that drives the uplift of their long-term preferred ratings does not result in a liquidity enhancement at instrument level.

SUPPORT RATINGS (SRS) AND SUPPORT RATING FLOORS (SRFS)

DEUTSCHE BANK, PFK, US AND AUSTRALIAN SUBSIDIARIES

Deutsche Bank's and PFK's SRs of '5' and SRFs of 'No Floor' reflect our view that senior creditors cannot rely on receiving full extraordinary support from the sovereign if the banks become non-viable. This is due to the resolution legislation in place in Germany since 2015. The US subsidiaries' SRs reflect our view of Deutsche Bank's high propensity and ability to provide support.

TIER 2 SUBORDINATED DEBT AND HYBRID SECURITIES
DEUTSCHE BANK, DB - LONDON BRANCH, PFK, US AND AUSTRALIAN SUBSIDIARIES
The Tier 2 subordinated notes and hybrid securities issued by Deutsche Bank, DB - London branch and by issuing vehicles are notched down from Deutsche Bank's VR in accordance with our assessment of each instrument's respective risk of non-performance and relative loss severity.

The legacy, non-Capital Requirements Regulation (CRR) compliant Tier 1 securities issued by Deutsche Bank Contingent Capital Trust II and V and by Deutsche Postbank Funding Trust I, II and III are rated four notches below Deutsche Bank's VR, reflecting higher-than-average risk of loss severity (two notches), as well as high risk of non-performance (an additional two notches) given their partial discretionary coupon omission features.

Deutsche Bank's CRR compliant high- and low-trigger additional Tier 1 (AT1) securities are rated five notches below the bank's VR. The securities are notched down twice for loss severity risk as they can be converted to equity or written down well ahead of resolution, resulting in poor recovery prospects. In addition, they are notched down three times for high non-performance risk, reflecting their fully discretionary coupon omission features.

Deutsche Bank's EUR921 million AT1 coupon payment capacity disclosed at end-2018 exceeded the EUR330 million coupons that became due in April 2019. The bank's coupon payment flexibility has been thus far lower than foreign peers' due to a more restrictive definition of available distributable items (ADIs) in Germany. This, however, should improve under the upcoming implementation of the revised CRR. Non-payment of AT1 coupon would also be triggered by a breach of the bank's maximum distributable amount (MDA) relevant requirement of 11.8% for 2019. However, Deutsche Bank has a substantial buffer above this threshold.

STATE-GUARANTEED NOTES ISSUED BY THE FORMER DSL BANK
We have downgraded the ratings of PFK's four senior unsecured and one Tier 2 subordinated bond initially issued by Deutsche Siedlungs- und Landesrentenbank (DSL Bank) to 'A' from 'AA'. This follows Fitch's reassessment of the bonds' non-performance risk.

The German government (AAA/Stable/F1+) has guaranteed these bonds since their issuance by DSL Bank between 1993 and 1998. PFK became DSL Bank's legal successor in 2018 following its merger with Deutsche Postbank AG (DSL Bank merged into Deutsche Postbank in 2000). The guarantee was unaffected by the mergers and applies to the five bonds until their maturity. Hence, we see an extremely high probability that the government would fully reimburse grandfathered creditors, should the guarantee ever be triggered by a default of PFK.

However, we believe that the DSL Transformation Act ('DSL Bank-Umwandlungsgesetz') from 1999, on which the state guarantee is based, does not oblige the government to honour the guarantee on first demand. Therefore, in our opinion, there is no certainty that a reimbursement would be carried out on a timely basis.

To reflect this uncertainty, we have revised our assessment of the five bonds' non-performance risk by deriving it from PFK's creditworthiness. Consequently, we no longer notch down the ratings of the five bonds twice from the German sovereign rating. Instead, we notch them up three times from PFK's Long-Term IDR. The three-notch uplift reflects the outstanding recovery prospects arising from the guarantee.

RATING SENSITIVITIES
IDRs, VR, DCR, DEPOSIT AND SENIOR DEBT RATINGS
DEUTSCHE BANK, DB - LONDON BRANCH and PFK
The IDRs, VR and senior debt ratings of Deutsche Bank are primarily sensitive to its ability to stabilise its business model, generate acceptable returns and prudently manage its capital ratios. The Evolving Outlook reflects our view that the ratings will change in either direction over a one-to two-year horizon.

We would upgrade the ratings if the bank makes tangible and significant progress in refocusing on activities with a more adequate risk/return profile and capital usage, primarily by reducing its reliance on volatile and underperforming CIB segments.

In the absence of such measures, a continuation of the bank's weak operating performance would likely trigger a downgrade if we believe such underperformance jeopardises management's ability to build up or raise capital. Franchise erosion in CIB evidenced by market share declines in core businesses, particularly in global transaction banking and in fixed income and currencies sales and trading, would also put pressure on ratings.

A downgrade would also be triggered by a sharp or sustained deterioration of regulatory capital ratios threatening to breach regulatory requirements. A moderate decline of the CET1 ratio below the management targeted floor of 13% would remain commensurate with the current rating only if it is driven by compelling strategic adjustments.

A weakening of the bank's liquidity profile, which could be indicated by wholesale deposit outflows or a decreasing liquidity coverage ratio, could also put pressure on ratings.

Several regulatory investigations into Deutsche Bank's anti-money-laundering practices and controls are ongoing. Should they result in material fines or business restrictions, this could put ratings under pressure, depending on the impact and mitigating actions. Failure to remedy regulatory findings in key jurisdictions could also put ratings under pressure if this indicates fundamental risk control shortcomings.

The DCRs, deposit and debt ratings are primarily sensitive to changes in the Long-Term IDR. In addition, the DCRs, deposit and senior preferred debt ratings are sensitive to a reduction of the subordinated and senior non-preferred debt buffers relative to the recapitalisation amount likely to be needed to restore viability and prevent default on preferred obligations.

PFK's and DB - London branch's ratings will continue to move in tandem with Deutsche Bank's.

STATE-GUARANTEED NOTES ISSUED BY THE FORMER DSL BANK
The ratings of the five state-guaranteed bonds initially issued by DSL Bank are primarily sensitive to changes in PFK's Long-Term IDR. They are also sensitive to a multi-notch downgrade of Germany's Long-Term IDR and to changes to the relevant legislation, in particular to the DSL Transformation Act. They are also sensitive to timely execution of the guarantee by the sovereign, should PFK become unable to honour its obligations.

SRS AND SRFS
An upgrade of Deutsche Bank and PFK's SRs and an upward revision of the SRFs would be contingent on a positive change in the sovereign's propensity to support banks' senior creditors in full. While not impossible, this is highly unlikely, in our view.

US AND AUSTRALIAN SUBSIDIARIES
The ratings of Deutsche Bank's US and Australian subsidiaries would move in line with the parent's IDRs. They are also sensitive to changes in our assumptions around the propensity of Deutsche Bank to provide timely support.

TIER 2 SUBORDINATED DEBT AND HYBRID SECURITIES
The Tier 2 subordinated notes and hybrid securities are primarily sensitive to changes in Deutsche Bank's VR. The securities' ratings are also sensitive to a change in their notching, which could arise if Fitch changes its assessment of their non-performance risk relative to the risk captured in the VR. This may reflect a change in capital management in the group or an unexpected shift in regulatory buffer requirements, for example.

We could notch the AT1 securities further down from the VR if the ADIs decline significantly or if either heightened regulatory Pillar 2 requirements or CET1 erosion deplete its MDA buffer.

The rating actions are as follows:
Deutsche Bank AG
Long-Term IDR downgraded to 'BBB' from 'BBB+'; Outlook Evolving
Short-Term IDR affirmed at 'F2'
Viability Rating downgraded to 'bbb' from 'bbb+'
Support Rating affirmed at '5'
Support Rating Floor affirmed at 'No Floor'
Derivative Counterparty Rating downgraded to 'BBB+(dcr)' from 'A-(dcr)'
Long-term senior preferred debt, issuance programme and deposit ratings downgraded to 'BBB+' from 'A-'
Short-Term senior preferred debt, issuance programme and deposit ratings affirmed at 'F2'
Long-term senior non-preferred debt and issuance programme ratings downgraded to 'BBB' from 'BBB+'
USD debt issuance programme's short-term senior non-preferred rating: 'F2' withdrawn
Subordinated Tier 2 debt rating downgraded to 'BBB-' from 'BBB'
Additional Tier 1 notes downgraded to 'B+' from 'BB-'

Deutsche Bank AG, London Branch
Long-Term IDR downgraded to 'BBB' from 'BBB+'; Outlook Evolving
Short-Term IDR affirmed at 'F2'
Derivative Counterparty Rating downgraded to 'BBB+(dcr)' from 'A-(dcr)'
Long-term senior preferred debt and deposit ratings downgraded to 'BBB+' from 'A-'
Short-term commercial paper programme and deposit ratings affirmed at 'F2'
Long-term senior non-preferred debt rating downgraded to 'BBB' from 'BBB+'
Tier 2 subordinated debt rating downgraded to 'BBB-' from 'BBB'

DB Privat- und Firmenkundenbank AG
Long-Term IDR downgraded to 'BBB' from 'BBB+'; Outlook Evolving
Short-Term IDR affirmed at 'F2'
Viability Rating downgraded to 'bbb' from 'bbb+'
Support Rating affirmed at '5'
Support Rating Floor affirmed at 'No Floor'
Long-term deposit rating downgraded to 'BBB+' from 'A-'
Short-term deposit rating affirmed at 'F2'
Commercial paper programme ratings affirmed at 'F2' and withdrawn
Long-term senior unsecured debt issuance programme rating downgraded to 'BBB' from 'BBB+' and withdrawn
Short-term senior unsecured debt issuance programme rating affirmed at 'F2' and withdrawn
State-guaranteed senior unsecured (DE0002432549, DE0002432556, DE0002435708 and DE0002461860) and Tier 2 subordinated (XS0081864489) bonds issued by the former DSL Bank: downgraded to 'A' from 'AA'

Deutsche Bank Securities, Inc.
Long-Term IDR downgraded to 'BBB' from 'BBB+'; Outlook Evolving
Short-Term IDR affirmed at 'F2'
Support Rating affirmed at '2'
Derivative Counterparty Rating downgraded to 'BBB(dcr)' from 'BBB+(dcr)'

Deutsche Bank Trust Company Americas
Long-Term IDR downgraded to 'BBB' from 'BBB+'; Outlook Evolving
Short-Term IDR affirmed at 'F2'

Support Rating affirmed at '2'
Senior unsecured deposit ratings affirmed at 'F2'
Deutsche Bank Trust Corporation
Long-Term IDR downgraded to 'BBB' from 'BBB+'; Outlook Evolving
Short-Term IDR affirmed at 'F2'
Support Rating affirmed at '2'

Deutsche Bank Australia Ltd.
Commercial paper short-term rating affirmed at 'F2'

Deutsche Bank Contingent Capital Trust II and V
Preferred securities ratings downgraded to 'BB-' from 'BB'

Deutsche Postbank Funding Trust I, II and III
Preferred securities ratings downgraded to 'BB-' from 'BB'

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Additional information is available on www.fitchratings.com
Applicable Criteria
Bank Rating Criteria (pub. 12 Oct 2018)
Non-Bank Financial Institutions Rating Criteria (pub. 12 Oct 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

Additional Disclosures
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