Research Update:

Deutsche Bank 'BBB+/A-2' Ratings Affirmed Announcement; Outlook Stable

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PRIMARY CREDIT ANALYST

Giles Edwards
London
(44) 20-7176-7014
giles.edwards
@spglobal.com

SECONDARY CONTACT

Harm Semder
Frankfurt
(49) 69-33-999-158
harm.semder
@spglobal.com

ADDITIONAL CONTACT

Pierre Gautier
Paris
(33) 1-4420-6711
pierre.gautier
@spglobal.com

Overview

- Deutsche Bank has announced a substantial further downsizing of its investment banking business as part of a wider range of multiyear restructuring and investment measures to enhance profitability.
- We see these repositioning measures as a logical and necessary response to the deteriorated operating environment that the bank faces to restore its profitability over the medium term.
- We are affirming our 'BBB+/A-2' issuer credit ratings on the bank and its core operating subsidiaries.
- The stable outlook acknowledges execution risks, but reflects our expectation that management delivers in line with the financial targets and projections it has set out, and that this supports the bank's creditworthiness relative to its peers.

Rating Action

On July 15, 2019, S&P Global Ratings affirmed its long-term and short-term issuer credit ratings on Deutsche Bank and its core U.S. and European subsidiaries at 'BBB+/A-2'. The outlook is stable.

At the same time, we affirmed our 'trAAA/A-1+' Turkish national scale issuer credit ratings on Deutsche Bank. We also affirmed our resolution counterparty ratings on these entities.

We affirmed our issue ratings on Deutsche Bank's hybrid instruments, including our 'BBB-' rating on the bank's senior subordinated debt.

Rationale

On July 7, Deutsche Bank announced a series of measures to restructure its operations, including a global exit of equities sales and trading, and a significant reduction in the capital it allocates to its remaining investment banking business. We have affirmed our ratings because we see the strategic announcement as a logical and necessary reaction to the deeper environmental challenges that Deutsche Bank now faces, and we view the downsizing and reinvestment plans as executable, albeit not without risk. While capitalization will decline, we see this as modest and sustainable, and we expect the still-solid, less-leveraged balance sheet as likely to continue to underpin investor confidence and so give management time to deliver the restructuring. In view of these factors, we continue to consider the ratings well-positioned relative to stronger European and U.S. peers.

While we maintain a stable outlook on Deutsche Bank based on a forward-looking view that management will execute thoroughly on the revised strategy, we see more downside than upside pressures at this time. We cannot rule out execution risks in this strategy, much of which depend on initiatives in 2019 and 2020. We are mindful that the macroeconomic and capital market environment remains difficult, and that even if management eventually achieves its target of an 8% return on tangible equity (ROTE) by 2022, this will most likely bring the bank into the pack among domestic and European peers that also barely cover their cost of capital. While the current management team has demonstrated its ability to cut costs, the envisaged profitability improvement hinges principally on a deep and broad multiyear effort to re-engineer infrastructure and processes while also substantially downsizing the investment bank. Despite the best efforts of management, execution could be impeded or delayed. We will monitor closely in the next quarters how the bank performs against its objectives and to what extent the revenue attrition coming from large cuts in the equities sales and trading is smaller than what management currently anticipates.

Group credit profile

Despite having delivered on its cost management targets in the past year since CEO Christian Sewing took office, Deutsche Bank, like its European peers, faces a more difficult economic and market environment. We see no reason to think that this very weak revenue environment will improve in the coming years, although some activities continue to see secular growth. This puts the onus on banks, and particularly those with the weakest returns, to refocus and radically re-engineer business operations to seize cost efficiencies. These efficiencies will only reveal themselves as these investments bear fruit, however. Deutsche Bank also faces a specific imperative to narrow the focus of its investment banking business, which, despite previous rounds of cuts, has retained waterfront coverage across key asset classes--even with super-low risk-adjusted returns in some activities. In addition, coming rounds of Basel III finalization will increase capital requirements.

Deutsche Bank's announcement is one of a series of restructuring measures that management has taken in the past five years. It marks a change in the refocusing of the Investment Bank division, together with a strong investment mandate to seek out revenue growth and further reposition the bank's technology, operations and client service proposition, as well as to extract significant efficiencies. We draw some confidence from the much-improved credibility in execution that the management team has established over the past year, and an evident willingness to continue to improve the control environment.

Still, while management rightly highlights the bank's sources of franchise strength, key challenges remain. We expect the run-down of noncore exposures in the Capital Release Unit as likely to be relatively more straightforward and front-loaded, though progress will become evident mainly during 2020 and the related operational risk-weighted assets will be harder to remove. In our view, the main challenges come from the weak environment that could further undermine revenue, as well as the risk that the bank will not be able to realize cost efficiencies as fast as planned.

Despite these uncertainties, we take as a given that Deutsche Bank will maintain its balance sheet strength within the bounds that it has set out. We expect that funding and liquidity metrics will remain robust, and the bank's sustained high bail-in buffer will likely support a ratio of at least 10% under our additional loss absorption capacity (ALAC) methodology. We anticipate also that management will continue to execute cautiously its ongoing program to redeploy some of the excess liquidity into assets that do not lead to a negative earnings drag.

We see as notable the apparent regulatory agreement of management's intention to reduce Deutsche Bank's common equity Tier 1 (CET1) target to 12.5% from 13.0%. This will help the bank to finance its transformation without recourse to a further capital injection, and it appears to represent increased regulatory comfort for the bank. We now expect Deutsche Bank's S&P Global Ratings risk-adjusted capital (RAC) ratio will be 8.0%-8.5% in the coming years, down from our previous expectation of 8.5%-9.0%. We still see this as adequate, but only in the context of a better controlled bank. While we expect that the market will continue to focus primarily on financial performance, an absence of new risk-related events would help to break the feedback loop of relatively weak sentiment toward the bank.

Rated subsidiaries in the U.S.

While Deutsche Bank will transact in a narrower range of products in future, we see it as committed to maintaining its strong franchise in fixed income and currencies, and also retaining its investment banking presence in the main global financial centers. In particular, the U.S. will continue to account for about 20% of group revenue. We therefore maintain our view of Deutsche Bank's U.S. subsidiaries as core to the ultimate parent and likely to be part of an orderly resolution plan that seeks to avoid the default on senior unsecured liabilities. We therefore continue to equalize our ratings on these subsidiaries with the 'bbb+' group credit profile of Deutsche Bank.

May-pay hybrids

As an EU-domiciled bank, Deutsche Bank's additional Tier 1 instruments also face immediate coupon nonpayment risk if the bank has insufficient additional distributable items (ADI), and heightened risk if it breaches its capital requirements--defined as the sum of the Pillar 1 and Pillar 2 requirements plus combined buffers, known as the minimum distributable amount (MDA) thresholds.

The bank has had limited headroom on its ADIs in the past and its German generally accepted accounting principles (GAAP) reserves would likely be affected by the substantial reported loss in 2019. However, the bank is now able to calculate capacity with reference to its International Financial Reporting Standards reserves, and we understand that these reserves are likely to remain sufficient.

The bank's MDA thresholds for 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%, 17.7%, respectively, at the end of March 2019. While not unusual among European peers, we already regarded Deutsche Bank's 1.9% headroom on the CET1 requirement as notable in the context of the potential volatility of its CET1 ratio, and so we see it as a reason to constrain the related issue ratings. The bank has now indicated it anticipates tighter headroom of just under 1.0%, due to an expected CET1 ratio of about 12.7% at year-end 2020. However, this ratio occurs as part of a strategy that should reduce some of the cyclicality of future earnings. We therefore have affirmed our ratings on these hybrids, but we would very likely lower our ratings on them, even without a revision of the 'bbb' stand-alone credit profile (SACP), if we expect that headroom would decrease more than the bank has guided.

Outlook

The stable outlook acknowledges the challenges inherent in Deutsche Bank's deep and difficult restructuring. The challenges are heightened by the weak economic environment and evolving banking regulation, notably for investment banking activities. However, we expect that the management team will deliver on the initiatives within its control and that key clients and stakeholders will remain engaged and supportive. Under our central scenario, this will help the bank to minimize the attrition of revenue in the next two years.

Downside scenario

We could lower our long-term issuer credit rating on Deutsche Bank and its core subsidiaries in the next 12-24 months if we see material setbacks in the delivery of the updated strategy, including significant doubt that management will hit its profitability targets through 2022. This could be more likely in the event of management missteps or a more costly, or longer, turnaround than anticipated, but it would most likely result from an even more 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 a 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 SACP, and so lower our issue ratings on all rated debt, including the senior subordinated debt and regulatory capital instruments.

Upside scenario

We currently consider an upgrade to be a remote possibility in the coming 12-24 months, given the magnitude of the restructuring. We would likely see solid delivery of the strategy through end-2020 as rather supporting the existing ratings, rather than necessarily narrowing the gap relative to peers.

If we upgraded the bank, 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

Deutsche Bank AG

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)

Deutsche Bank AG (cont.)

Support	+2
ALAC Support	+2
GRE Support	0
Group Support	0
Government Support	0
Additional Factors	-1

SACP--Stand-alone credit profile. GRE--Government-related entity. ALAC--Additional loss-absorbing capital

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
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
- 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: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment 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 Ratings Affirmed As Profitability Creeps Upward; Key Challenges Remain, May 24, 2019
- Bulletin: As Commerzbank And Deutsche Bank Talks End, What Now For The Two Banks?, April 26, 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 European Bank Ratings In 2019, Feb. 28, 2019

Ratings List

Ratings Affirmed	
Deutsche Bank AG	
Issuer Credit Rating	BBB+/Stable/A-2
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 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 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	

Ratings Affirmed

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

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