



**James von Moltke at UBS European Conference,
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Transcript



Q&A

Daniele Brupbacher (UBS Research): Good morning and welcome, ladies and gentlemen. Thank you very much for your time. And we hope that you're enjoying this year's European conference. I'm Daniele Brupbacher from UBS Research, the European banks team. I would like to introduce you to James von Moltke. He's been CFO of Deutsche Bank since 1st July 2017. Before that, as most of you will know, James was treasurer of Citigroup. He also worked for JP Morgan, Credit Suisse and Morgan Stanley. So he truly knows the industry. So what I would like to do today is to go through a couple of questions and then also open up to the audience for Q&A.

I wanted to start with not the third quarter, not the fourth quarter but with 2019. You set a very clear ambition to reach a return on tangible equity of at least 4% in 2019. And if my maths is correct, I would say you need revenues of at least at the level of 2017. So my question really is to start the debate, how do you think about – how can you grow revenues, grow in general and cut costs during and after 2019, at the same time?

James von Moltke (Deutsche Bank): Sure. Thank you, Daniele. And thank you for having me here this morning. We're obviously very focused on our 2019 target. As we thought about some of the strategic decisions we took this year to reset the company we created a set of near-term targets that we could then hit, re-establish credibility in the marketplace was a critical goal. And, hence, two targets of headcount and adjusted costs for 2018. Similarly, for 2019 we have headcount and adjusted cost targets and an associated ROTE target. Frankly, the path to the ROTE is pretty simply an operating leverage story. We must stabilise and grow our revenues relative to the trends of the past couple of years, and at the same time bring down expenses.

As I think about it, your analysis is roughly right. The model's pretty simple to create in terms of what the revenue performance needs to be next year.

There's clearly some growth from the 2018 level that is required. Happily, a big portion of our business operate in growth markets at the moment, whether that's PCB in Germany which is growing steadily in the mid-single digit range. Asset management is a strong business. Obviously, GTB is also in a growing market. So we would expect to have some uplift from that.

We are also naturally somewhat subject to the environment, particularly in our capital markets and global markets business. But there, while there is some market dependence, there's also a degree of steady revenue that we get there.

At the same time, we need to bring down expenses. Our target is to bring our adjusted costs down from €23 billion this year to €22 billion next year. That's a lot of operating leverage that we create on the expense side. And given that we've taken the steps that we intended to take strategically in terms of front office action, the focus now in just making the platform more efficient, we're very carefully to make sure that that has as little revenue impact as possible, make sure we preserve the revenue-generating power of the franchise.



Daniele Brupbacher: You laid out very clear cost targets in absolute terms. I think the market likes that. But, to be a little provocative why is it different this time? And if you could also repeat what you said during the fixed income quarterly results call? I think you made a very clear statement regarding your previous medium-term €21 billion adjusted cost target.

James von Moltke: Sure. Starting with the second part of the question. Previously, we talked to a €21 billion absolute expense target for 2021 which we withdrew in the second quarter 2018. I said two things on the last earnings and fixed income call. First, we need to do better than that on the adjusted cost side. So in our forward-looking planning now would suggest expenses need to be lower, and potentially substantially lower, than €21 billion in 2021. But also, after next year, we want to migrate to a cost-to-income ratio way of measuring and managing the company. We think that's more appropriate over the long term.

In the near term, we want to stick with absolute cost targets because we want to be very clear on what we're being measured against and what we can drive the company to. This feeds into the first part of your question – what is different this time?

Obviously, I don't want to comment on prior management. But in this management team, we are extremely focused, disciplined on the execution that it's going to take to make this platform more efficient. We recognise that at the current efficiency ratio, there simply isn't the margin to deliver what we need to deliver to all of our stakeholders. Whether that's credit investors, rating agencies, ultimately equity investors, we simply have to drive greater efficiency.

We see a lot of opportunities to do that in the company as its structured today. And we've talked a lot about the initiatives that are out there, whether that's synergies from the domestic market merger that are on the way, whether that's some of the exits that we've now completed, particularly, Poland where the partial sale of our retail business completed over the weekend. We've taken the front office actions we have that puts us on a good path for some expense benefits next year.

We're working to really address some of the underlying drivers of expenses over several years. So if I put that altogether that gives us confidence about the future trajectory of the expense line.

Daniele Brupbacher: Great, thank you. Just back on revenues again. CIB was the one division which has more volatility. And, this year, you also said it in your interim report for the third quarter that you expect revenues to be down in all relevant lines. Looking to 2019, which areas do you expect to grow? And in that context as well, the leverage reallocation you've talked about, there was one interesting slide you used at a conference June where you showed about €240 billion of leverage exposure is running at relatively low revenue margins. Where do we stand in terms of the reallocation of that low return leverage?

James von Moltke: I'll go in reverse order again. We published a target for leverage reduction and we were able to act much more quickly than we'd originally expected against that target. In that June presentation that you referred to, we noted that in our leverage exposure, there is a relatively sizeable part of the balance sheet that was earning on average



about 42 basis points of yield. And it's that part of the balance sheet that we went after very aggressively.

So, the roughly €100 billion of leverage exposure that came out of the franchise during the second quarter of 2018 was predominantly in areas like repo, to some extent prime finance, where we simply don't earn returns on capital that are acceptable to us or to our shareholders.

Having accelerated those reductions in the second quarter, we now are really just looking at optimising the existing leverage balance sheet. We came down a little bit in the third quarter, and I would expect the fourth quarter to be in a similar range to the second and third quarter levels. Now within that, we do have an opportunity to continue to optimise, to invest leverage exposure where our clients value it, where we think the returns are acceptable. We also have a much smaller non-strategic book that's running off that. Again, it gives us an ability to reinvest leverage exposure.

If I turn then to the revenue side of your question, naturally, that has had an impact on revenues. We've made, over several years now, a number of perimeter decisions. And naturally, those perimeter decisions have had an impact on our relative revenue performance and our market share. It's that trend that we need to work now to reverse.

I'm a believer that when you focus resources in the areas that are your greatest strength, where you have unique market positions and unique selling propositions, you can use those resources to much greater effect. And, so, that reinvestment as part of the strategic decisions we took in the spring is something that I expect to see playing itself out over the coming quarters. And that underlines our commitment to stabilise and grow revenues from here given that resource reallocation.

Daniele Brupbacher: And would you see those benefits in both equities and fixed income? Or are there also cyclical issues on the rates platform which makes you, adjust certain trajectories?

James von Moltke: So that's the challenge. In equities and fixed income remember, fixed income is obviously a larger part of our total markets revenues. But our total trading revenues are a minority of the full firm's revenues. Our trading businesses are naturally subject to market environment, market volatility. But there's also a huge amount else that goes into relative performance.

Currency translation differences go into that. Business mix, whether you're concentrated in Europe, whether you're in the commodities business or not, those are all things that feed into your relative revenue performance in those areas. We would look to grow though from here. We have some areas of real strength that I think we will continue to invest in and seek to capitalise on. Our FX and credit businesses are true strengths of ours. And I think as we focus on, stabilising the rates platform and growing from here, we are making investments in technology which should also help drive a recovery in our rate performance.



In equities, as many of you know, it's a tough environment, especially given the impact of MiFID. And the group of banks that fall, in the second half of the top ten need to work hard to define their market proposition to defend and grow revenues in what would hopefully be a growing market environment for equities. And that's what we're executing on. Peter Selman, is doing a superb job refocusing the equities platform and making sure that our resources are invested where we can be differentiated.

Daniele Brupbacher: Another area which has always been core to Deutsche Bank is GTB, global transaction banking. This business goes right to the roots of Deutsche Bank's international business model. So it's been a bit disappointing to look at results, to be honest, because they've been drifting downwards. But you made quite some optimistic statements with regards to the potential of that. Can you tell us where does your optimism come from? Is it the clients, the technology, pricing?

James von Moltke: First of all, I agree with you. It's absolutely core to our franchise. It's a deep set of client relationships that we serve in cash management, trade financing, payment services, and also in security and agency services. And once you're installed, in that business, you develop very strong client relationships. And to a reasonable extent, you're hard to dislodge.

It is a business that relies on continued investment, continually winning new business, investing in technology, investing in new product capabilities to serve your clients' needs. And we are determined to do that. We're clearly allocating the resources to do that. And that should allow us to grow from here. When you look at our peers, it is a market that has been growing in the mid to upper single digits for a couple of years now. And we haven't participated as much as we like in that growth.

A big part of the industry growth for a lot of our peers has come from interest rate increases, which, to the extent that you are concentrated in US dollars is a great thing. If you're a euro-based bank, like us, it means you don't participate quite as much. Over time, we would expect in a rising interest rate environment to provide an uplift in that business. And in principle, we need to grow it from where it has been recently in kind of a mid-€900s million revenue area up to €1 billion a quarter and beyond. That's what we're focused on doing under new leadership with Stefan Hoops and, with our ongoing investments.

Another part of why you've seen our growth rate relative to peers be less than the marketplace has been some of the perimeter decisions which we've talked about now for a couple of years. But perimeter decisions to sharpen the footprint, to some degree also funding costs and funding allocations have flown through. So it hasn't been a picture of growth, when seen externally that is in line with how we would see the underlying performance in terms of client wins, the installed base of the revenues that exist in that GTB business.

Daniele Brupbacher: Great. You mentioned interest rates. Obviously, that's important for almost every European bank and also for Deutsche, and you have given transparency around your sensitivity. If I recall correctly, you said you think that about a third of the total revenue increase, comes from higher rates. Is that something you would reiterate today?



James von Moltke: What we've said was that our path to the 10% ROTE aspiration starts with establishing the 4% ROTE not as an endpoint by any stretch of the imagination but as a platform, and a waypoint towards the 10% ROTE, that we know our investors and the analysts struggle to see in our model and we need to prove that over time.

Interest rates are clearly part of that improvement. First of all with the negative 40 basis points on the deposits with the central banks places the European banks in a difficult environment. In the long term, it's unsustainable because as you can see, it's very difficult to earn a margin when one of the principal input factors is programmatically loss making. But as that reverses, naturally that drag would go away. We are keenly waiting for a change in monetary policy to allow that to happen. And we have two large deposit books, again, concentrated in euros in GTB and the retail bank. So, yes, an improved interest rate environment would contribute greatly towards that progress on the path to the 10% ROTE.

I will say, one thing that as an analytical question you'd ask is why is Deutsche Bank more exposed to interest rate sensitivity than our peers. We are, in some ways, deliberately short in our investment posture, which gives us a great deal of sensitivity to that uplift. Secondly, we're more institutional than most of our peers. And we have a much lower loan-to-deposit ratio than many of our peers. All of that makes us more sensitive, to the upside from interest rates than your typical mixed retail commercial bank.

Daniele Brupbacher: Just to wrap up on the revenue side. You mentioned PCB briefly earlier. What is your outlook in Germany, be it the retail business, probably also the corporate business – I think you have some initiatives there as well.

James von Moltke: Overall, we feel quite positive actually. There's been underlying growth in the German retail market, also in commercial lending. We are participating in that growth but would like to participate more. Over the last several months and quarters, we have seen accelerating loan growth which is encouraging and we would obviously like that trend to continue. And so, yes, I think that environment is a positive one for us.

Remember, we're going through a pretty significant restructuring and integration in Germany, having completed the legal merger of Postbank into the retail and commercial bank. We now have a single legal entity and very clear plans to execute on over several years to simplify that platform, take a significant amount of expense out of the combined platforms. But importantly, we will not lose focus on the revenue side of the equation as we will provide services in two different brands which we think of as client segments. The Postbank brand is a more simple, everyday banking offering with a more, affluent investment-oriented clientele served by the Deutsche Bank brand. We think this is a great strategy to address the opportunities of the German market. And again, it plays into our confidence about operating leverage from here in our model.

Daniele Brupbacher: Great. The other opportunity, I think, which you have discussed on results calls is excess liquidity. Your Liquidity Coverage Ratio seems high and the liquidity buffers are in billion terms also very high. What's is the opportunity here? Can you give us some sensitivity and how you think about that? What would be normal? What's the go-to level on probably just the LCR?



James von Moltke: On LCR, many of our international peers operate with an LCR of around 120%. And so, against that measure, we would have significant room to reduce liquidity. In practice, it takes a lot of work and effort to optimise the liquidity picture. But as we said on our third quarter earnings call, we absolutely intend to do that. We intend to reinvest, to reduce the drag of excess liquidity on our earnings.

The decision up until now has been a deliberate one. We recognised that after 2016, it was important to present an extremely solid, stable balance sheet profile in the marketplace. We've also worked on our liquidity management, liquidity reporting and liquidity risk models. We think that investment is now paying off and gives us the opportunity to become a little bit less conservative and taking some of the excess conservatism out to reduce the associated drag. Orders of magnitude, there's a lot of room. And I would characterise that in the hundreds of millions of revenues as we reinvest judiciously. And that would play out over the next four to five quarters as we put the balance sheet to work. So that's another reason that gives us confidence about the revenue uplift and part of the trajectory that we have into next year.

Daniele Brupbacher: Funding costs are also important. I'm an equities guy so it is sometimes a bit complicated to understand some of the various layers. But I think you made public statements saying that your senior non-preferred spreads are still not where you want them to be. How should we read this as equities people? What concerns the credit markets? And on does your fund transfer pricing was there a conscious decision to put more funding costs into the businesses, or is it really just that your external funding spreads are too high?

James von Moltke: It's a mixture. In our external reporting, there has been a mixture of higher external funding costs and some reallocation internally from the corporate centre and into the businesses. And yes, funds transfer pricing is enormously important. We continue to work on that because, frankly, to run a bank properly, you need to make sure that both on the asset side and liability side, the right pricing signals are being delivered to your bankers and, by extension, to the clients in how we serve them.

To your point about the credit environment, first of all, we think that our credit rating and our spreads don't reflect the strength of the balance sheet that we have. We've done an enormous amount to both recapitalise and clean up the balance sheet over the past several years. And I think, by the way, the rating agencies recognise that. So if you read the rating agency commentaries, there is no concern expressed about the balance sheet. It's all about earnings, which is why I refer to a virtuous circle that comes with improved earnings. I would expect improved credit spreads, hopefully over time improved ratings and if you like, a virtuous circle that can help in the momentum.

What drives the credit investors? Frankly, there is some unhealthy cross talk between the equity markets and the credit markets. As I talk to credit investors and analysts, frankly, they're very sanguine about the name because they see the strength of the balance sheet. They understand that we are well capitalised. And while they wait for the same, catalyst of improved earnings, they feel comfortable as creditors. And it is our job to bring down those spreads over time.



There have also been some unique attributes to DB. The inability to issue non-preferred debt, often that's not that familiar for an equity investor universe, but we have been hamstrung relative to other European banks in how the German government chose to implement bail-in laws. So, they essentially subordinated all of our outstanding debt on a statutory basis. And for several years, we were only able to issue that subordinated debt at relatively higher spreads, whereas in other markets they did it in reverse. Other European countries said all of your existing debt you can continue to issue, what's known as senior preferred, and you can build this more expensive debt over time.

The regulatory structure in Germany presents a clear disadvantage in terms of ongoing funding costs but is a clear advantage if you're a creditor of Deutsche Bank because you have all of this subordination of the non-preferred debt underneath you. And so, it's important for creditors to know that they're facing off against a counterparty that is rated at A3 at Deutsche Bank, as much as the focus of the marketplace tends to be on our senior non-preferred because that's all we were issuing for some period of time.

This idiosyncrasy for us is now in the rear view mirror. The other idiosyncrasy that will go away is a gate on our ability to pay coupons, on our AT1 instruments. I expect that to go away with legislative action in early next year. And we will start to look more normal, more like our peers, especially ultimately when a CDS contract comes out referring that A3 rating which we expect imminently. We'll just look more normal from a credit perspective, and I do expect that to have a positive impact on our company.

Daniele Brupbacher: Great. We have talked a lot about revenues and costs but not about capital yet. I mean, we had the stress results a couple days ago. Tell us how we should read those and how it impacts your capital planning.

James von Moltke: We are very comfortable with the outcome. At 8.1% post-stress ratio, we're clearly able to manage through a highly stressful period. And for those who weren't paying a lot of attention, this stress scenario for the German banking industry was far more stressful than other markets, with the exception of the UK. So we feel that that was a pretty rigorous test for us.

We also pointed out in our press summary that there was about 100 basis points of what we would call out as methodology differences that really don't reflect how we think we perform in that environment; whether that is not giving us credit for de-risking that has taken place in the past. This includes the repetition of losses, for example, on the Poland transaction and the treatment of market risks. And so we think we would fare better in the real world and closer, if you like, to where our true peer group played out.

What I would point out as positives in that test is that the capital depletion - the percentage of your core tier one capital ratio that is lost through credit losses was extremely low for us at 2.2%. This was much lower than the peer group, again, reflecting our assertion that the balance sheet is very strong, stable and well-capitalised. So we're very comfortable with that outcome. But I think it was a rigorous and demanding test for the industry.



Daniele Brupbacher: Great. I think we have to wrap it up. We have three more seconds. I would like to thank you very much for coming to our conference. It's been a great pleasure having you on stage as well.

James von Moltke: A pleasure to be here.

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