Financial Institutions

DBRS: Deutsche Bank: Despite Solid Balance Sheet Fundamentals, Headline Risk Remains a Key Challenge

Insight beyond the rating

DBRS sees Deutsche Bank as facing another period of market stress given recent headlines regarding U.S. regulatory issues. Negative headlines are impacting the Bank's reputation and driving negative market perceptions.

Summary:

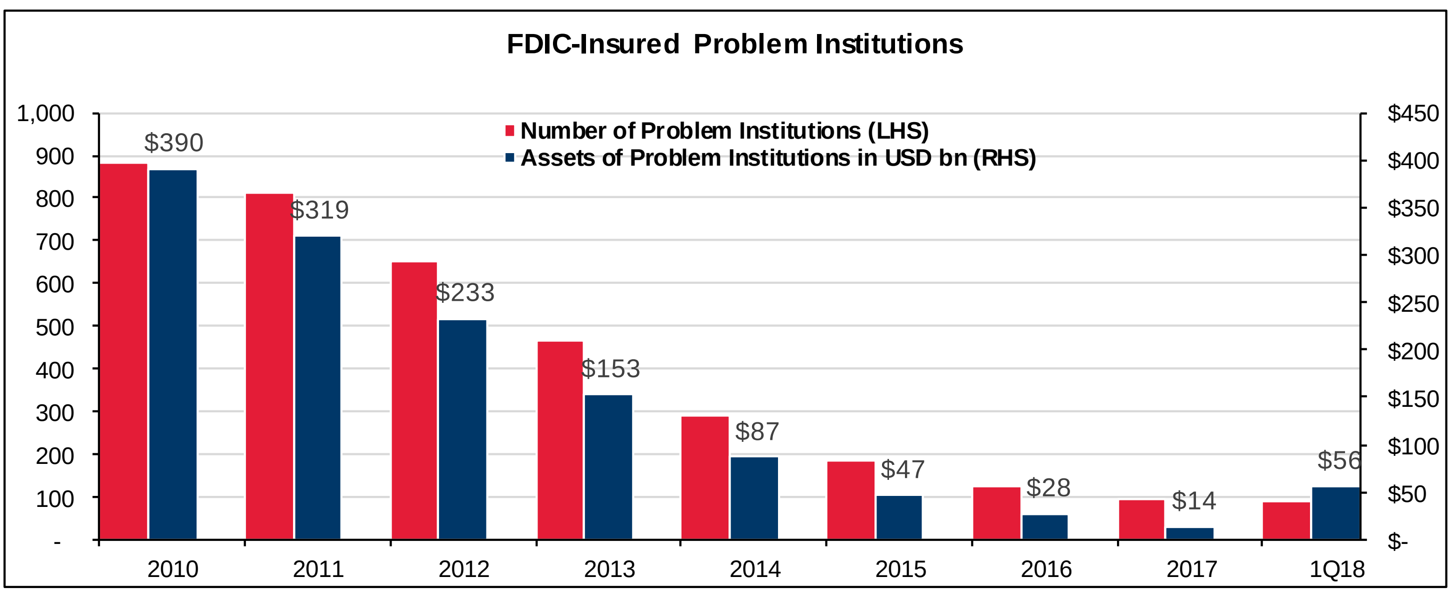
- Deutsche Bank AG (DB or the Bank, A (low), Negative trend for Long-term Issuer Rating) is managing through another period of market stress following recent speculation of heightened regulatory issues in the U.S.
- DBRS sees that the uncertainties regarding DB's regulatory issues within the U.S. are driving investor concerns.
- While management has taken appropriate steps to manage through various periods of market stress and position the Bank well for future growth, the Bank faces the challenge of headline risk, which is impacting DB's reputation and driving negative market perceptions.

Deutsche Bank AG (DB or the Bank, A (low), Negative trend for Long-Term Issuer Rating) is managing through another period of market stress following recent speculation of heightened regulatory issues in the U.S. While management has taken appropriate steps to manage through various periods of market stress and position the Bank well for future growth, the Bank faces the challenge of headline risk, which is impacting DB's reputation and driving negative market perceptions. As these headlines continue, DBRS sees the Bank as increasingly susceptible to weakening investor and counterpary confidence, highlighting a significant DB-specific risk, given the Bank's relatively large use of wholesale funding.

Specifically, this speculation of heighted regulatory issues in the U.S. is related to the publication of the FDIC 1Q18 Quarterly Banking Profile (QBP), which includes details of FDIC-insured institutions on an aggregate basis. In the QBP, it is reported that assets of FDIC-insured "problem" institutions jumped by USD 42.5 billion in 1Q18, diverging from the downward trend since 2010 (see Exhibit 1). At the same time, the number of FDIC-insured "problem" institutions continues to decline, indicating that the addition of these assets was from a sizable financial institution.

The FDIC does not explicitly name the institution(s) that is/are driving this change, and DB is prohibited from commenting on regulatory actions. The market has perceived the QBP report includes DB given that assets within its U.S. bank subsidiary correspond to the approximate change in assets at "problem" institutions. DB's U.S. bank subsidiary, Deutsche Bank Trust Company Americas (DBTCA, A (low), Negative trend for Long-Term Issuer Rating) reported assets of USD 42.1 billion as of 1Q18.

Exhibit 1



DBRS sees the uncertainties regarding DB's regulatory issues within the U.S. as driving investor concerns. U.S. regulators are highly focused on advancements in systems and technology. While DB continues to invest in these areas, progress has been slower than anticipated and the Bank has significantly more work to to. DBRS recognizes that investments in systems, processes, and people will play a critical role in the Bank's future success, and expects that this will drive an elevated cost/income ratio for the foreseeable future. DBRS maintains the view that investment in the franchise is necessary, even if this results in pressure on the bottom line and lower than expected returns. DBRS notes that DBTCA has significant levels of capital and liquidity.

DBRS sees DB as having the ability to absorb these elevated costs over the medium-term, given its solid balance sheet fundamentals. The Bank has made some progress with legacy issues by settling numerous litigation issues, running down the noncore porfolio, and strengthening the Bank's balance sheet through a capital raise and IPO of the asset management unit. DB's risk-adjusted regulatory capital position is at the upper end of the global peer group (fully-loaded CET1 ratio of 13.4%). While DBRS sees that management has taken appropriate steps to manage through various periods of market stress and position the Bank well for future growth, continued negative headlines can contribute to challenges that are outside the Bank's control.

DBRS has a Long-Term Issuer Rating on Deutsche Bank of A (low) with a Negative trend. DBRS revised the trend to Negative on 9 May 2018 to reflect the significant challenges that DB faces in meeting strategic targets, at a time when execution risk remains elevated due to the scale of its restructuring task, and the need to demonstrate management stability and cohesiveness going forward.

Downward pressure on the rating could arise if DB is unable to successfully execute on its strategic plan, which could provoke another period of weakened market confidence, or if the Bank is unable to make timely progress with its systems and technology enhancements, which is necessary in order to successfully compete with global peers. DBRS has also noted a decline in business positioning and will monitor trends over the coming year; if DBRS sees continuing declines in market share in areas considered to be strategically important, this would put pressure on the rating.

The trend could revert back to Stable if the Bank demonstrates progress in successfully executing its strategic initiatives by meeting targets related to cost reductions, profitability and capitalisation, while maintaining a solid risk profile. Additionally, demonstrating an ability to maintain and/or improve business positioning in key strategic areas would be supportive of the current rating level.

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