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Fitch Upgrades Deutsche Bank to 'A-'; Outlook Stable

Fitch Ratings - Frankfurt am Main - 03 Jul 2023: Fitch Ratings has upgraded Deutsche Bank AG's Long-Term Issuer Default Rating (IDR) to 'A-' from 'BBB+' and Viability Rating (VR) to 'a-' from 'bbb+'. The Outlook on the Long-Term IDR is Stable. As a result of the upgrades, Fitch has also upgraded Deutsche Bank's debt ratings. A full list of rating actions is below.

The upgrades reflect the completion of Deutsche Bank's restructuring initiated in 2019, in particular the improvements in cost-efficiency and more balanced revenue mix and business profile, where we expect corporate and retail banking to provide sufficient buffers to absorb the inherent volatility from capital market activities. This resulted in an operating profit/risk-weighted assets (RWA) ratio of 1.5% in 2022, with adequate medium-term profitability prospects. We also expect Deutsche Bank to maintain adequate capitalisation and sound asset quality and liquidity metrics.

Key Rating Drivers

Restructuring Completed: Deutsche Bank's ratings reflect the completion of the bulk of its restructuring and its more stable, fairly diversified business model, albeit with a still significant contribution from more volatile capital market activities and lack of pricing power in its domestic banking market. The bank's sound risk appetite, asset quality, funding and liquidity also support the ratings.

Profitability has substantially improved in the past four years, but we expect it to remain below that of higher-rated global trading and universal bank (GTUB) peers in the near term. Weaker organic capital generation and a lower regulatory leverage ratio than the European peer average also result in capitalisation being only adequate.

More Balanced Business Profile: Deutsche Bank has a fairly diversified business model focused on four businesses: corporate bank (CB), investment bank (IB), private bank (PB) and asset management (AM). The revenue contribution and cost/income ratios of the CB and PB have substantially improved and together with AM, these businesses accounted for 65% of total revenue in 1Q23.

We view the generation of stable revenue from these businesses combined with the execution of the planned cost-savings as key to mitigating the inherent earnings volatility in the IB. The latter has successfully stabilised its franchise and maintained leading global positions in fixed-income and currency trading, which performed well in 2022.

Improving Risk Controls, Conservative Appetite: The bank remains exposed to several ongoing legal and regulatory proceedings. We expect some of these to result in fines, which should be manageable but could result in reputational damage. Large investments and improved anti-financial crime controls since 2019 have reduced litigation costs and regulatory fines, although the bank's business model will remain exposed to these risks. Underwriting standards are conservative. Appetite for market risk is fairly limited despite sizeable trading operations. Interest-rate risk in the banking book is largely hedged.

Resilient Asset Quality: We expect Deutsche Bank's asset quality to deteriorate moderately in the current downturn and its impaired loans ratio to rise to about 3% in the next two years, which is higher than the average for German banks.

Asset quality deterioration will likely be driven by defaults in the bank's commercial real estate and corporate portfolios as the credit environment deteriorates, but we expect the impaired loans ratio to remain overall resilient due to the bank's large exposure to Germany and good record of managing credit risk. This mitigates lower precautionary loan loss allowances compared to peers. Non-loan assets are generally of good credit quality and are neutral to our asset quality assessment.

Improving Earnings: The bank's operating profit/RWAs steadily improved to 1.5% in 2022 having been loss-making in 2019. We expect rising net interest income to more than offset declining revenue in the IB and higher loan impairment charges (LICs) in 2023 and 2024. This should help Deutsche Bank maintain operating profit/RWAs above 1.5%. We also expect growing net commission income to sustain revenue growth in the medium term. However, we believe that the full realisation of the planned cost cutting and revenue growth initiatives remains subject to material execution risk in a more volatile economic environment.

Adequate Capitalisation: Capitalisation is adequate in light of lower risks from the bank's restructuring. They reflect Deutsche Bank's improved but still modest capital generation relative to GTUB peers. We expect the common equity Tier 1 (CET1) capital ratio and the Basel leverage ratio to remain in line with management's targets of about 13% and at least 4.5%, respectively, in the next two years, as capital retention should offset regulatory RWA inflation and fading business growth should result in broadly flat leverage exposure.

Diversified Funding; Sound Liquidity: We expect the bank to take measures to maintain its solid domestic deposit franchise, limiting its reliance on market funding in the next two years. The latter is well-diversified but remains more confidence-sensitive than GTUB peers, as evidenced by the sharper fall of Deutsche Bank's bond prices in late March. We expect liquidity to decline close to the management's target as targeted longer-term refinancing operations drawings mature and loans and deposits balances to remain broadly in line with their end-March 2023 levels.

Rating Sensitivities

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/ Downgrade

The ratings could come under pressure if the bank fails to at least stabilise its cost-efficiency, if revenue significantly declines due to market-wide disruptions or franchise erosion in core businesses relative to its peers, leading to operating profit/RWAs durably below 1.5%. Rating pressure would also arise if a deterioration of credit conditions globally hinders adequate operating profits, for example, by triggering persistently high LICs and durably eroding the CET1 ratio below 13%.

We could also downgrade the ratings if the bank's liquidity metrics fall more than expected, leading to loss of market confidence, without swift recovery prospects or following significantly higher than anticipated operational losses, for example, from civil litigation or regulatory fines.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

Upgrade potential is limited, given Deutsche Bank's business profile. An upgrade would require an increase of the bank's CET1 ratio to well above 14%, contingent on a substantial improvement of the bank's cost-efficiency along with franchise growth in stable and profitable businesses. This would have to result in a balanced revenue profile, as seen at higher rated peers, and operating profit/RWAs sustainably above 2%. An upgrade would also require clear evidence of lower confidence sensitivity in the bank's funding and liquidity, while maintaining sound risk appetite and asset quality.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Deutsche Bank's funding & liquidity score of 'a-' constrains the bank's Short-Term IDR at 'F2', the lower of two options mapping to the Long-Term IDR of 'A-'.

As a result of the upgrade of Deutsche Bank's Long-Term IDR, Fitch has upgraded the bank's Derivative Counterparty Rating (DCR), long-term deposit and senior preferred (SP) debt ratings by one notch. These ratings are one notch above Deutsche Bank's Long-Term IDR, and the senior non-preferred (SNP) debt rating is aligned with the Long-Term IDR. This reflects the protection of preferred creditors by large SNP and junior debt buffers (19.2% of RWAs at end-March 2023). The buffers are underpinned by the bank's subordinated minimum requirement for own funds and eligible liabilities (MREL) of 25.4% of RWAs, which is higher than its total loss-absorbing capacity (TLAC) requirement of 23.1%.

Following the upgrade of Deutsche Bank's long-term deposit and senior preferred debt to 'A' from 'A-', Fitch has also upgraded the respective short-term debt ratings to 'F1' from 'F2'.

We rate the Tier 2 notes two notches below the VR to reflect the above-average loss severity arising from their subordination. We rate Deutsche Bank's additional Tier 1 (AT1) notes and legacy Tier 1 notes issued by Deutsche Postbank Funding Trust I and III four notches below the VR (two notches for poor recovery prospects and two notches for non-performance risk). The bank had a broadly stable and sufficient buffer of 251bp over the minimum required to pay coupons on its AT1s at end-March 2023.

Senior and Tier 2 bonds issued by DSL Bank are notched up three times from Deutsche Bank's Long-Term IDR, reflecting their outstanding recovery prospects. The German government (AAA/Stable), which guarantees these bonds until maturity, is extremely likely to fully reimburse the grandfathered creditors if Deutsche Bank defaults. However, we see no certainty that a reimbursement would be on a timely basis as the DSL Transformation Act from 1999, on which the state guarantee is based, does not oblige the government to honour the guarantee on first demand.

Deutsche Bank's GSR of 'no support' reflects our view that due to the resolution legislation in place in Germany since 2015, senior creditors cannot rely on full extraordinary support from the sovereign if the bank becomes non-viable.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

An upgrade of the Short-Term IDR would require an upgrade of the bank's funding & liquidity score to 'a' from 'a-'. This would require maintaining a liquidity buffer in line with management's targets and clear evidence of lower confidence sensitivity in the bank's funding.

The DCR, long-term deposit and senior debt ratings are primarily sensitive to changes in the Long-Term IDR. The DCR, long-term deposit and SP debt ratings could also be downgraded if the subordinated and SNP debt buffers reduce to below 10% of RWAs, assuming the bank continues to meet its total MREL requirements with a combination of SP and more junior debt and equity.

The ratings of the AT1 and Tier 2 notes are primarily sensitive to changes in the VR. The AT1 debt could be downgraded to five notches below the VR, including three notches for non-performance, if we no longer expect the bank to maintain a buffer of over 100bp over distribution-relevant requirements.

The ratings of the state-guaranteed bonds issued by DSL Bank are primarily sensitive to changes in Deutsche Bank's Long-Term IDR, and to timely execution of the guarantee by the sovereign, should the bank be unable to honour its obligations.

An upgrade of the GSR would require a positive change in the sovereign's propensity to support the bank's senior creditors. While not impossible, this is highly unlikely, in our view.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

Deutsche Bank AG, London Branch's ratings are equalised with Deutsche Bank's as they refer to the same legal entity.

The IDRs of Deutsche Bank's US subsidiaries Deutsche Bank Securities, Inc., Deutsche Bank Trust Corporation and Deutsche Bank Trust Company Americas are based on their Shareholder Support Ratings (SSRs), which are aligned with Deutsche Bank's Long-Term IDR. This reflects the subsidiaries' high integration and core roles in supporting the group's capital-market activities.

Deutsche Bank Australia Ltd.'s commercial paper programme rating is aligned with Deutsche Bank's short-term preferred debt ratings based on the strong support available from the parent.

The DCR of Deutsche Bank Securities Inc. also reflects the protection that could accrue to derivative counterparties from the bail-in debt and equity buffers at the level of the intermediate holding company DB USA Corporation.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

The ratings of the above entities are primarily sensitive to Deutsche Bank's IDRs, from which they are derived. The subsidiaries' ratings are also sensitive to a perceived decline in their strategic importance to the group.

VR ADJUSTMENTS

The capitalisation and leverage score of 'bbb+' is below the 'a' category implied score, due to the following adjustment reason: internal capital generation and growth (negative).

Best/Worst Case Rating Scenario

International scale credit ratings of Financial Institutions and Covered Bond issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

Public Ratings with Credit Linkage to other ratings

The IDRs of Deutsche Bank Securities, Inc., Deutsche Bank Trust Corporation and Deutsche Bank Trust Company Americas are linked to Deutsche Bank's Long-Term IDR.

ESG Considerations

The highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

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Rating Actions

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Deutsche Bank AG	LT IDR	A-	Upgrade		BBB+
	ST IDR	F2	Affirmed		F2
	Viability	a-	Upgrade		bbb+
	DCR	A(dcr)	Upgrade		A-(dcr)
	Government Support	ns	Affirmed		ns
• subordinated	LT	BB+	Upgrade		BB
• long-term deposits	LT	A	Upgrade		A-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• Senior preferred	LT	A	Upgrade		A-
• Senior non-preferred	LT	A-	Upgrade		BBB+
• subordinated	LT	BBB	Upgrade		BBB-
• guaranteed	LT	AA-	Upgrade		A+
• short-term deposits	ST	F1	Upgrade		F2
• Senior preferred	ST	F1	Upgrade		F2
Deutsche Postbank Funding Trust III					
• subordinated	LT	BB+	Upgrade		BB
Deutsche Bank Australia Ltd.					

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• senior unsecured	ST	F1	Upgrade		F2
Deutsche Bank Trust Corporation	LT IDR	A-	Upgrade		BBB+
	ST IDR	F2	Affirmed		F2
	Shareholder Support	a-	Upgrade		bbb+
Deutsche Postbank Funding Trust I					
• subordinated	LT	BB+	Upgrade		BB
Deutsche Bank AG, London Branch	LT IDR	A-	Upgrade		BBB+
	ST IDR	F2	Affirmed		F2
	DCR	A(dcr)	Upgrade		A-(dcr)
• long-term deposits	LT	A	Upgrade		A-
• Senior	LT	A	Upgrade		A-

ENTITY/DEBT	RATING			RECOVERY	PRIOR
preferred					
• Senior non-preferred	LT	A-	Upgrade		BBB+
• subordinated	LT	BBB	Upgrade		BBB-
• short-term deposits	ST	F1	Upgrade		F2
• Senior preferred	ST	F1	Upgrade		F2
Deutsche Bank Securities, Inc.	LT IDR	A-	Upgrade		BBB+
	ST IDR	F2	Affirmed		F2
	DCR	A(dcr)	Upgrade		A-(dcr)
	Shareholder Support	a-	Upgrade		bbb+
Deutsche Bank Trust Company Americas	LT IDR	A-	Upgrade		BBB+

ENTITY/DEBT	RATING			RECOVERY	PRIOR
	ST IDR	F2	Affirmed		F2
	Shareholder Support	a-	Upgrade		bbb+
• senior unsecured	ST	F2	Affirmed		F2

RATINGS KEY	OUTLOOK	WATCH
POSITIVE	⊕	⬘
NEGATIVE	⊖	⬙
EVOLVING	◈	◆
STABLE	⊡	

Applicable Criteria

Bank Rating Criteria (pub.07 Sep 2022) (including rating assumption sensitivity)

Non-Bank Financial Institutions Rating Criteria (pub.05 May 2023) (including rating assumption sensitivity)

Additional Disclosures

Solicitation Status

Endorsement Status

Deutsche Bank AG	EU Issued, UK Endorsed
Deutsche Bank AG, London Branch	EU Issued, UK Endorsed
Deutsche Bank Australia Ltd.	EU Issued, UK Endorsed

Deutsche Bank Securities, Inc.	EU Issued, UK Endorsed
Deutsche Bank Trust Company Americas	EU Issued, UK Endorsed
Deutsche Bank Trust Corporation	EU Issued, UK Endorsed
Deutsche Postbank Funding Trust I	EU Issued, UK Endorsed
Deutsche Postbank Funding Trust III	EU Issued, UK Endorsed

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