FitchRatings

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Fitch Upgrades Deutsche Bank to 'BBB+; Maintains Positive Outlook

Fitch Ratings - Frankfurt am Main - 23 Sep 2021: Fitch Ratings has upgraded Deutsche Bank AG's Long-Term Issuer Default Rating (IDR) to 'BBB+' from 'BBB' and Viability Rating (VR) to 'bbb+' from 'bbb'. The Outlook on the Long-Term IDR remains Positive. Deutsche Bank's Derivative Counterparty Rating (DCR) has been upgraded to 'A-(dcr)' from 'BBB+(dcr)' and its long-term deposit and senior preferred (SP) debt ratings to 'A-' from 'BBB+'.

The upgrades reflect good progress and increasingly manageable challenges arising from the restructuring initiated in 2019, which we expect to remain firmly on track in 2H21 and 2022. We have reflected this progress in improved scores for the bank's company profile ('bbb+') and earnings & profitability ('bbb-'), both with a positive outlook.

We believe rapidly improving economic conditions, supported by comprehensive fiscal and monetary support to the economy and vaccination progress, are increasing the chances of a successful execution of the last phase of the bank's restructuring in 2022. We have also reflected these benign economic conditions by revising the outlook on the bank's operating environment score of 'aa-' to stable from negative, in line with domestic peers'. However, we expect the German banking sector's structural weaknesses to continue to complicate the bank's efforts to raise the profitability of its domestic corporate bank (CB) and private bank (PB) operations.

Key Rating Drivers

VR AND IDRs

Deutsche Bank's IDRs and VR reflect a strengthened business model and an improving franchise, sound asset quality, funding and liquidity as well as adequate capitalisation. The ratings also reflect weak four-year historical average profitability, which we expect to improve further as the restructuring nears completion.

The upgrade of the company profile score to 'bbb+' reflects continued progress in the bank's restructuring and stabilisation of its business model, with most significant revenue improvement and franchise stabilisation at the investment bank (IB). The positive outlook on the company profile score signals the potential to further consolidate its market shares in the IB and improve the still weak cost/income ratio of the bank's domestic operations. A successful completion of the restructuring should be commensurate with a company profile in the 'a' category.

However, Deutsche Bank's domestic CB and PB operations continue to suffer from weaker pricing power than its peer group of US and European global trading and universal banks (GTUB), which tend to enjoy leading domestic franchises in less fragmented markets where pricing discipline is higher. Improving pricing power will be crucial to mitigating the inherent volatility of its (even downsized and refocused) IB operations.

The progress in executing Deutsche Bank's restructuring is also underpinned by management and strategic stability over the past two years, both at group level and in the most confidence-sensitive IB and CB divisions. We have revised the outlook on the bank's management & strategy score of 'bbb+' to positive from stable, as we expect the improved strategic clarity and consistency to increasingly foster re-engagement with clients and other stakeholders as well as revenue growth. Similar to the company profile score, a successful completion of the restructuring could validate the strength of the bank's strategic objectives and execution, and eventually lift its management & strategy score to the 'a' category.

Deutsche Bank has maintained a good record of managing credit risk, a fairly limited appetite for market risk despite its large trading operations, and moderate appetite for growth. Non-financial risk controls still lag behind peers', but large multi-year investments, tight scrutiny from relevant regulators and consistent management focus on strengthening anti-financial crime controls have brought about significant improvements over the last quarters. Litigation costs are decreasing, and the bank faces fewer demands from regulators for remediation measures than a few years ago, but its business model will continue to expose the bank to this type of risk.

Profitability is improving, but its four-year average operating return on risk-weighted assets (RWAs) is still much weaker than GTUB peers' and weighs on its ratings. However, we have upgraded the bank's earnings & profitability score to 'bbb-' as we expect its operating return/RWA to be close to 1% in 2021 and 1.5% in 2022. The positive outlook on the score signals our expectation that the majority of revenue and cost measures will feed through the bank's income statement by 2023. However, in the short term, both the CB and PB will continue to weigh significantly on the group's profitability.

The pace of downward normalisation of the IB's revenue is another driver of our assessment of the group's profitability. The division is unlikely to enjoy conditions as benign as in 2020 and 1H21 in the longer term. However, we believe most of the IB's revenue growth in 2020 and 1H21 was driven by structural improvements such as strategic and management stabilisation, and we also believe that IB's revenue generation beyond 2021 should benefit from regained market shares in key products and lower-than-expected revenue attrition from strategic exits.

We could upgrade the score further if we believe that the core bank's recurring profitability (adjusted for the benign impact of the pandemic, especially in the IB) offers sufficient headroom to absorb reasonable unexpected challenges. More balanced revenues among the IB, CB, PB and asset management (AM) operations as well as improved cost efficiency and lower funding costs will more effectively mitigate the volatility inherent to the business model, especially in the IB. However, a higher earnings & profitability score would also require some evidence of the CB's and PB's ability to grow revenue generation, e.g. the CB's payments business and ancillary activities.

DB is likely to have executed by end-2021 about 70% of the cost reduction targeted by its restructuring plan by end-2022, with only modest residual restructuring charges to be booked in 2022. The wind-down of the capital release unit (CRU), whose annual costs halved to EUR1.7 billion in 2020 from 2018, remains a key contributor to cost reductions.

The bank should also be able to counter volume-driven incremental costs and the implementation of enhanced anti financial crime controls through further staff reduction, real-estate disposals post-pandemic and streamlined processes.

We believe the group's loan impairment charges (LIC) could increase moderately next year as state support to the economy is being phased out, but this is unlikely to weigh significantly on profitability. The bank's LIC ratio guidance of 15bp for 2021 reflects a prudent use of pandemic-driven management adjustments to provisioning models and looks increasingly conservative in light of the low 7bp booked in 1H21.

Loan quality is a rating strength. Its resilience through the pandemic reflects generally prudent underwriting in recent years and, similar to peers', extensive state support to the economy, including moratoria, furlough schemes and loosened insolvency regulation.

We view the bank's exposure to sectors that are more vulnerable to the aftermath of the pandemic (especially commercial real estate) as manageable. As economic activity is normalising faster than initially expected, the phasing-out of state support seems increasingly unlikely to trigger a severe and lasting deterioration of corporates and SMEs' credit quality. Therefore, we now expect the bank's four-year average Stage 3 loans ratio (including purchased or originated credit-impaired loans) to remain below 3% over the next two years and decrease thereafter. As a result, we have revised the outlook on the asset quality score of 'a' to stable from negative.

Deutsche Bank's capitalisation & leverage score of 'bbb+'/stable reflects adequate capitalisation metrics in light of increasingly manageable execution risk from the restructuring as well as improving, but still modest, average internal capital generation relative to peers'.

Its common equity Tier 1 (CET1) ratio offers sufficient headroom over management's 12.5% floor to accommodate an expected 20bp impact from further regulatory RWA inflation in 2H21, as well as reasonable unexpected adverse earnings developments or RWA volatility. The bank has maintained a satisfactory and higher-than-expected CET1 ratio through the pandemic. The moderate decline to 13.2% at end-1H21 from 13.6% at end-2020 was mainly driven by regulatory inflation (TRIM decisions, CRR amendments) of credit RWAs, which outweighed reduced market and operational risk RWAs. The 270bp buffer over the total capital requirement (currently the most constraining) at end-1H21 offers sufficient headroom over distribution-relevant requirements.

The 4.8% fully-loaded leverage ratio at end-1H21 benefitted from a recent additional Tier 1 (AT1) issue and offers a reasonable buffer over regulatory requirements (3.23% at end-1H21, rising to 3.75% from 2023). We believe the ratio will be roughly stable in 2H21 and is on track to meeting management's target of 4.5% from 2022, as declining leverage exposure in the CRU and the completion of the transfer of the prime brokerage business to BNP Paribas by end-2021 should broadly offset selective business growth in the core bank. The pro-forma leverage ratio (after execution of the prime brokerage transfer) of 4.3% at end-1H21 including central bank balances that have been excluded by regulatory exemptions since 2020, is not particularly conservative but acceptable as it is inflated by deposit inflows and use of ECB's TLTRO.

Deutsche Bank's funding & liquidity score of 'a-'/stable reflects stable and comfortable liquidity and diversified funding sources. We believe its funding remains more confidence-sensitive than peers', but tightening issuance spreads relative to peers' show improving market confidence in light of the restructuring progress and improving performance prospects. The bank has made good progress in passing on negative rates, predominantly to corporate depositors and, increasingly, to PB clients, with EUR110 billion of deposits affected overall in the CB and the PB at end-1H21. Amid the negative interest-rate environment, this helps contain earnings pressure arising from the bank's increase in excess deposits over gross loans since the start of the pandemic.

While the bank can continue to exploit its tightened issuance spreads to pre-fund opportunistically, its market funding needs remain low as it continues to deleverage. Consequently, it now expects to issue about EUR15 billion of debt in 2021, which is at the low end of its initial guidance and well short of its maturing EUR22 billion. Its medium-term debt maturity profile is comfortable and its reliance on short-term unsecured wholesale funding is modest.

Deutsche Bank's transitional minimum requirement for own funds and eligible liabilities (MREL) amounted to 8.58% of total liabilities and own funds at end-1H21. The bank's eligible debt buffer exceeded this minimum by a comfortable EUR21 billion. Its high-quality liquid assets of EUR224 billion and liquidity coverage ratio of 143% (EUR67 billion surplus over minimum requirements) are comfortable and have benefitted from sound core deposit inflows and, similar to peers, extensive and opportunistic use of the ECB's TLTRO III through the pandemic.

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 'BBB+'.

SUPPORT RATINGS (SR) AND SUPPORT RATING FLOORS (SRF)

Deutsche Bank's SR of '5' and SRF of 'No Floor' reflect 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.

DEUTSCHE BANK AG, LONDON BRANCH; DEUTSCHE BANK SECURITIES INC.; DEUTSCHE BANK TRUST COMPANY AMERICAS; AND DEUTSCHE BANK TRUST CORPORATION

Deutsche Bank AG, London Branch's ratings are equalised with Deutsche Bank's as they refer to the same legal entity. The ratings of Deutsche Bank's US subsidiaries are equalised with Deutsche Bank's IDRs, which, along with their SRs, reflect the subsidiaries' high integration with the group, and core roles, especially in supporting its capital-market activities.

DCR, DEPOSIT, SP AND SENIOR NON-PREFERRED (SNP) DEBT RATINGS

Deutsche Bank and other group entities' DCRs, long-term deposit and SP debt ratings are one notch above the entities' respective Long-Term IDRs. This reflects the protection of preferred creditors by the group's large buffer of SNP and more junior debt (22% of RWAs at end-1H21). The SNP debt ratings of DB and its London branch are aligned with their Long-Term IDRs for the same reason.

The buffer is currently underpinned by the bank's total MREL, which is still more constraining than its total loss absorbing capacity (TLAC) requirement of 20.53% of RWAs, which itself is more constraining than its MREL subordination requirement. The latter is set to rise by end-2021, become the most constraining and ensure the SNP- and-more junior debt buffer will remain above 10% of RWAs.

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.

Deutsche Bank's funding & liquidity score of 'a-' constrains the short-term deposit and SP debt ratings at 'F2', the lower of two options mapping to an 'A-' long-term preferred rating. Deutsche Bank Australia Ltd.'s commercial paper programme rating is aligned with Deutsche Bank's short-term preferred ratings based on the strong support available from the parent.

SUBORDINATED DEBT

Deutsche Bank's Tier 2 notes are notched down twice from the VR to reflect their above-average loss severity resulting from their subordinated status. Deutsche Bank's CRR-compliant AT1 notes and the legacy Tier 1 securities issued by Deutsche Postbank Funding Trust I, II and III are rated four notches below the VR. This consists of two notches for their deep subordination and another two notches for non-performance risk given their non-easily activated coupon omission.

Deutsche Bank's buffer over distribution-relevant requirements, which could trigger coupon restrictions on the CRR-compliant AT1s, were broadly stable and satisfactory at 270bp at end-1H21. Its most constraining regulatory capital requirement is on total capital, since the CET1 requirement was lowered to 10.44% from 11.6% in 1Q20.

STATE-GUARANTEED BONDS

Four senior and one 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 in a Deutsche Bank default. However, we see no certainty that a reimbursement would be carried out 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.

Rating Sensitivities

Factors that could, individually or collectively, lead to negative rating action/ downgrade:

The Positive Outlook and the ratings could come under pressure if the bank fails to consistently adhere to its cost-reduction plan, if it significantly misses its revenue targets for its key business lines, or if we see evidence of franchise erosion in core businesses relative to peers'. Rating pressure would also arise if economic setbacks hinder the maintenance of adequate profits in the medium term, e.g. by triggering persistently high LIC and, potentially, eroding the CET1 ratio materially below 12.5% without swift recovery prospects.

The ratings of Deutsche Bank AG's London Branch and other subsidiaries are sensitive to the parent's Long-Term IDR, from which they are derived. The subsidiaries' ratings are also sensitive to a decline in their strategic importance to the group.

The DCRs, deposit and SP debt ratings are sensitive to a downgrade of the respective IDRs, and to a reduction of the subordinated and SNP debt buffers to below 10% of RWAs, assuming the bank continues to meet its total MREL requirements with a combination of SP and more junior debt.

The ratings of the AT1 and Tier 2 notes are primarily sensitive to changes in the VR. The CRR-compliant 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 notching of these notes is also sensitive to an unexpected increase in requirements that would trigger coupon restrictions, or to a decline in distributable reserves.

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.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

A rating upgrade would require sufficient evidence in 2H21 and 2022 that Deutsche Bank has durably strengthened its franchise and business model, avoided revenue attrition at the core bank, and recouped lost ground relative to its GTUB peers in the IB. Such evidence includes more adequate profitability through sustainable revenue growth in the CB and PB, revenue trends in IB broadly in line with the market amid a normalisation of market conditions, reduction in non-core businesses according to plan (especially by completing the exit from the prime brokerage business by end-2021 and through wind-down progress at the CRU), and cost reductions in line with management's 70% cost-income target at group level.

Beside achieving management's restructuring targets in 2022, upward rating pressure would also depend on the bank achieving an operating profit/RWA of close to 1.5% in 2022 and good prospects of maintaining resilient and sound profitability thereafter, while sustainably keeping CET1 and leverage ratios of at least 12.5% and 4.5%, respectively.

An upgrade of the VR and Long-Term IDRs would likely result in upgrades of the DCR as well as long-term deposit, senior and junior debt ratings. The short-term deposit and SP debt ratings would likely be upgraded if the long-term ratings are upgraded, but the Short-Term IDR would likely be affirmed, unless we also revise 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 such as durably tighter funding spreads, driven by more certainty that the bank's business model and internal capital generation are firmly strengthening.

An upgrade of Deutsche Bank' SR and an upward revision of the SRF would rely 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.

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.

ESG Considerations

Unless otherwise disclosed in this section, 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	BBB+	Upgrade		BBB
	ST IDR	F2	Affirmed		F2
	Viability	bbb+	Upgrade		bbb
	Support	5	Affirmed		5
	Support Floor	NF	Affirmed		NF
	DCR	A-(dcr)	Upgrade		BBB+(dcr)
• subordinated	LT	BB	Upgrade		BB-
• long-term deposits	LT	A-	Upgrade		BBB+
• Senior	LT	A-	Upgrade		BBB+

ENTITY/DEBT	RATING			RECOVERY	PRIOR
preferred					
• Senior non-preferred	LT	BBB+	Upgrade		BBB
• subordinated	LT	BBB-	Upgrade		BB+
• guaranteed	LT	A+	Upgrade		A
• short-term deposits	ST	F2	Affirmed		F2
• Senior preferred	ST	F2	Affirmed		F2
Deutsche Postbank Funding Trust III					
• subordinated	LT	BB	Upgrade		BB-
Deutsche Postbank Funding Trust II					

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• subordinated	LT	BB	Upgrade		BB-
Deutsche Bank Australia Ltd.					
• senior unsecured	ST	F2	Affirmed		F2
Deutsche Bank Trust Corporation	LT IDR	BBB+ ⊕	Upgrade		BBB ⊕
	ST IDR	F2	Affirmed		F2
	Support	2	Affirmed		2
Deutsche Postbank Funding Trust I					
• subordinated	LT	BB	Upgrade		BB-
Deutsche Bank AG, London Branch	LT IDR	BBB+ ⊕	Upgrade		BBB ⊕
	ST IDR	F2	Affirmed		F2
	DCR	A-(dcr)	Upgrade		BBB+(dcr)

ENTITY/DEBT	RATING			RECOVERY	PRIOR
• long-term deposits	LT	A-	Upgrade		BBB+
• Senior preferred	LT	A-	Upgrade		BBB+
• Senior non-preferred	LT	BBB+	Upgrade		BBB
• subordinated	LT	BBB-	Upgrade		BB+
• short-term deposits	ST	F2	Affirmed		F2
• Senior preferred	ST	F2	Affirmed		F2
Deutsche Bank Securities, Inc.	LT IDR	BBB+ ⊕	Upgrade		BBB ⊕
	ST IDR	F2	Affirmed		F2
	Support	2	Affirmed		2
	DCR	A-(dcr)	Upgrade		BBB+(dcr)

ENTITY/DEBT	RATING			RECOVERY	PRIOR
Deutsche Bank Trust Company Americas	LT IDR	BBB+ ⊕	Upgrade		BBB ⊕
	ST IDR	F2	Affirmed		F2
	Support	2	Affirmed		2
• senior unsecured	ST	F2	Affirmed		F2

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

Applicable Criteria

Bank Rating Criteria (pub.28 Feb 2020) (including rating assumption sensitivity)

Non-Bank Financial Institutions Rating Criteria (pub.28 Feb 2020) (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 II	EU Issued, UK Endorsed
Deutsche Postbank Funding Trust III	EU Issued, UK Endorsed

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