



Deutsche Bank AG

Deutsche Bank Q2 2018 Analyst Conference Call

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Transcript

Speakers:

Christian Sewing, Chief Executive Officer
James von Moltke, Chief Financial Officer
James Rivett, Head of Investor Relations



James Rivett

Thank you, Mia. Good morning and thank you all for joining us today. On our call today, our CEO Christian Sewing will speak first and then James von Moltke, our CFO, will take you through the earnings presentation in more detail, which is available for download on our website db.com.

After the presentation, we'll be happy to take your questions. Obviously, as always, there's a lot to cover today, so please try and limit it to two questions at a time. But, before we get started, I'd like to remind you that the presentation may contain forward-looking statements which may not develop as we currently expect. I'd therefore ask you take note of the precautionary warning on the forward-looking statements at the end of our materials. With that, let me hand over to Christian.

Christian Sewing

SLIDE 2 – EXECUTION ON STRATEGIC PLAN TO MATERIALLY IMPROVE RETURNS TO SHAREHOLDERS OVER TIME

Thank you, James, and welcome to you all. It is my pleasure to host our Second Quarter Results Call and to update you on the delivery of our strategy. The management team and I have two overriding objectives:

A, to materially improve returns to shareholders over time and, B, to use our conservative balance sheet to adjust our franchise while also taking advantage of responsible growth opportunities as they arise.

The results in quarter two and the strength of our balance sheet allow us to do just that.

This was a quarter of unprecedented change within our bank, and not for the sake of change, but change to rebuild our bank for focus and growth.

The results demonstrate our resilience in such a quarter but also that there is a new decisiveness of our management to deliver on promises in all areas specifically:

redefining the core of our bank which is well underway

reducing costs, a promising start but we need to keep the discipline and the momentum;

and reducing leverage exposure, and this is ahead of plan.



Again, let me emphasise, we achieved all of this despite significant external headwinds which demonstrate the strength of our franchise and the resilience of our businesses.

Some of this, but not all, is visible in our second quarter figures.

Strategically, in our Private & Commercial bank, we completed the legal merger of our German retail and commercial banking activities, enabling us, for the first time, to begin the process of extracting our targeted synergies.

And, as I said during the AGM, that we will accelerate the synergies and we are doing this now.

In Wealth Management we completed the integration of Sal. Oppenheim's operations into Deutsche Bank Wealth Management unit. This positions us well to accelerate growth and get efficiencies, and that in our home country.

In our Corporate & Investment Bank, let me start with equities. Here, we are well advanced in our strategic reshaping which we announced in May.

The business has been resilient despite the reduction in resources, especially in prime finance, with improved margins and a focus on core client relationships.

In US rates, we also made good progress towards our strategic goals of optimising the low-yielding parts of our balance sheet and we will further work on reducing cash and repo balances.

As promised, the planned adjustments in our front office staff are now well advanced and our focus will now shift to driving efficiencies in the supporting infrastructure functions.

This means that our front office staff can now focus on clients and revenues.

At the group level, our employee reductions are running in line with our year-end targets with headcount down by 1,700 in the quarter.

The headcount reductions in the quarter will help drive costs lower in the coming periods.

Our leverage exposure reduction is well underway and, in fact, is running ahead of our stated objectives.

Across the bank, we have reduced our leverage exposure by €114 billion before the impact of foreign exchange rate changes



in the second quarter, including over €80 billion in our prime finance and rates book.

This is what you can expect from this management team.

We set targets and we execute on them. As I stated at the outset, execution on our near-term plan and targets to improve the return for our shareholders over time is our core objective.

SLIDE 3 – Q2 2018 RESULTS DEMONSTRATE THE RESILIENCE OF OUR FRANCHISE

I will let James run through the details but slide three shows a high-level summary of our financial results.

While headline revenues were broadly flat versus the prior year, our performance was flattered by several one-time items.

But, on an underlying basis we know that the overall franchise is capable of delivering higher revenues in the future.

And, there are data points that show the quality of our people and the relevance of our business to our customers as we focus on our core segments.

To give you some examples:

in Global Transaction Banking, we grew underlying revenues on a sequential basis, and we expect the strength to continue in the coming quarters.

We are involved in a series of high-profile transactions in Origination & Advisory, and we have been extremely active in leveraged debt capital markets this year.

In Sales & Trading, we maintained our position as the leading European house and the fourth largest globally in fixed income and currencies.

Part of our underperformance versus peers came from stronger commodity markets, a business which we decided to exit in 2013.

But, we can see in the market that there are higher revenues available to us. That's why we were so determined to make the adjustments to our franchise quickly, and with our solid capital position, we have the levers we need to grow.

In our Private & Commercial Bank revenues were broadly flat, as our growth initiatives offset the ongoing headwinds from the negative interest rate environment.



Beyond the German legal entity merger, we have made good progress on the strategic agenda in PCB. Lending, as well as asset volumes increased, and will result in future revenue streams.

And, while DWS revenues declined, this was mostly driven by the non-recurrence of certain performance fees that are typically paid every other year.

Turning now to costs.

Our total non-interest expenses are broadly flat versus last year, but this reflects higher restructuring and severance as we executed on our restructuring plan and a more even recognition of performance-related compensation accruals than last year.

Importantly, in addition to the headcount reduction during the quarter, we reduced non-compensation costs across all cost categories, year-over-year, as management tightened its control over spending.

In other words, the trend on costs is now going in the right direction.

And, I'm fully aware that Deutsche Bank has a history of negative surprises on costs in the fourth quarter, including last year. As I made clear, when I took office, that pattern ends in 2018.

This year, we are accruing for performance-related compensation evenly through the year rather than backloading it.

In addition, we will benefit from the lower headcount and tighter controls over spending. All of this underpins my confidence that we will see declines in costs in the third and fourth quarters of this year.

James will refer to this in more detail on the next slides, but I would like to point out again that except compensation and benefits, for the reasons I laid out, we significantly decreased our operating costs across all remaining cost components versus the prior year.

But, despite this progress our profit before tax declined versus the prior, so overall we view these results as a step in the right direction but acknowledge that we have much more work to do to generate acceptable returns to our shareholders.



SLIDE 4 – A CONSERVATIVELY MANAGED BALANCE SHEET

As we execute on our objectives, it is of paramount importance that we manage our transformation from a basis of strong fundamentals.

The leadership team will continue to manage our balance sheet conservatively, which is shown on slide four.

Our Common Equity capital ratio at 13.7% improved by almost 40 basis points from the first quarter. It's amongst the highest in the industry and it's €11 billion above our regulatory requirement. This capital speaks for itself and gives us some buffer for growth.

Similarly, our €119 billion of total loss-absorbing capacity at the end of the quarter is well above both our TLAC and MREL requirements and provides a comfortable cushion for our depositors and counterparties.

Whether you think about market or credit risk, we manage our risk conservatively. Our market risk is close to historic lows and amongst the lowest of our global peers. Our credit risk is best in class and at historically low levels.

And, finally, with one of the lowest loan-to-deposit ratios of all European banks and €77 billion of liquidity above our regulatory requirements, we are well positioned to take advantage of growth opportunities as they arise without excessive risk-taking.

In short, we have all the resources we need to rebuild momentum.

SLIDE 5 – CLEARLY DEFINED NEAR-TERM TARGETS

Slide five shows the near-term external targets which the management team is focused on and against which you can expect us to deliver in the coming quarters as we delivered in the second quarter.

Our primary target is to generate a return on tangible equity of greater than 4% in 2019.

Although this may not seem very ambitious, we believe that it is realistic in the short-term and puts us on the right path to further improve returns in the coming years.



We recognise that we need to demonstrate to our shareholders that we can deliver on our near-term goals on our journey towards more ambitious longer-term targets.

To reach our 2019 return target, we must control the things that we can control, and that means we must significantly reduce our cost base further.

We have set an adjusted cost target of €23 billion this year and a further €1 billion reduction in 2019.

For this to happen, we are working on a series of short-term and longer-term initiatives, but perhaps the most tangible data point for you is headcount reduction where we, unfortunately, have to act in order to reduce cost and become more efficient.

Our cost target will entail a significant headcount reduction to below 93,000 at the end of 2018, and well below 90,000 in 2019.

And, we will execute on these targets while maintaining or Common Tier Equity ratio above 13%.

As I said in April, we will only achieve these goals if we execute, with discipline, clear milestones and adopt an execution focused mentality.

And, the last 100 days has given me and the entire management board all the confidence that this discipline and execution mentality exists and is now being lived every day.

SLIDE 5 – PROGRESS TOWARDS NEAR-TERM TARGETS

Slide six shows the progress that we have made in the first half of the years towards these near-term targets.

With a return on tangible equity of 1.8% in the first half of 2018, we obviously need to work to improve profitability in the coming quarters, but we are on track to meet our €23 billion target by the end of 2018, with adjusted costs of €11.9 in the first half which included annual bank levies, one-off IPO costs for DWS, and the recognition of certain German retail merger related costs.

Going forward, our commitment is to reduce adjusted costs in the third quarter compared to the second, and then again in the fourth quarter.



For this, all the work, including the headcount reductions already completed will pay off and, hence, we are very confident to reach our targets.

And, with that, let me hand over to James.

James von Moltke

SLIDE 7 – Q2 2018 GROUP FINANCIAL TARGETS

Thank you, Christian. Let us now turn to the financial summary on slide seven.

As Christian said, our second quarter results demonstrated resilience despite some of the idiosyncratic pressures we faced.

Revenues of €6.6 billion were broadly flat year-on-year on a reported basis.

Total non-interest expenses of €5.8 billion increased by 1% compared to the prior year quarter.

Cuts in adjusted costs were more than offset by higher restructuring and severance as we execute on our strategic objectives.

Restructuring and severance was €239 million in the quarter and €280 million for the first half.

Our profit before tax was €711 million and our tax rate remains elevated, reflecting the pronounced impact of non-deductible expenses relative to the level of pre-tax profits.

And, as a result, we generated €400 million of net income in the quarter with earnings per share of €0.03 or €0.17 excluding the annual AT1 coupon payments which occurred this quarter.

Tangible book value per share of €25.91 is up 1% compared to the prior quarter.

SLIDE 8 – ADJUSTED COSTS

Turning to our adjusted costs on slide eight.

Adjusted for the impact of foreign exchange translation, adjusted costs of €5.6 billion rose by 1% or €40 million versus the prior year period.

The increase included €160 million of higher compensation and benefits expenses.

This reflected higher deferrals for prior year rewards as we returned to a more normalised variable compensation structure



in 2017 and management's decision to pace the current year accruals for variable compensations more evenly through the year.

You can see on slide 23 of the appendix, we reduced costs on in all other categories, year-over-year, with approximately €100 million of savings as a result of management actions to optimise external support costs and IT spend.

SLIDE 9 – EMPLOYEES

Slide nine shows our progress in reducing the number of employees as we work to improve the efficiency of the firm.

Across the group, we have reduced our full-time equivalent workforce by approximately 1,700 in the quarter to 95,400.

Our front office staff reductions in the Corporate & Investment Bank are well advanced, with a decline of close to 1,000 in the second quarter.

And, as we execute on our target to reach 93,000 employees by year-end, we also need to adjust our infrastructure given our recent business changes.

As a reminder, we expect a reduction of 1,400 employees from the sale of our Polish retail and commercial banking operations, anticipated to close in the fourth quarter.

SLIDE 10 – CAPITAL RATIOS

Turning to our Common Equity Tier 1 ratio and fully-loaded leverage ratio on slide ten.

We ended the second quarter with a CET1 ratio of 13.7%, 38 basis points above the prior quarter, as we reduced credit and market risk-weighted assets in CIB.

Adjusted for FX, credit risk-weighted assets declined by approximately €8 billion in the quarter with roughly half coming from process enhancements; the rest came from reduced business volumes, including a small contribution from the deleveraging of our low-risk balance sheet in prime finance and US rates.

As Christian noted, this level of capitalisation gives us a strong foundation, both to manage through the current period of repositioning and to selectively grow our business.



As discussed in prior quarters, we've been anticipating additional regulatory changes including the guaranteed funds product which could negatively affect our CET1 ratio.

The expected timing of potential changes appears to be extending, among other things, due to the ongoing legislative process around CRR2.

As a consequence, our current expectation is that the impact of regulatory changes on the CET1 ratio this year should be less than previously thought and perhaps no more than 20 basis points.

As we gain greater clarity on the impact of regulatory changes next year and thereafter, we will continue to manage to a ratio of greater than 13% by growing capital through retained earnings over time and adjusting our capital needs through continued optimisation of the balance sheet.

Turning to the leverage ratio, our fully-loaded leverage ratio increased by 28 basis points to 4%, driven by an €85 billion reduction in leverage exposure or €114 billion on an FX-neutral basis.

The decline was materially all in equities and FIC, principally prime finance and rates, as we executive on our strategic objectives.

Reductions were across all products and categories, most notably secured financing transactions which were down by more than €40 billion, lower trading inventory and derivatives of €10 billion each, and further reductions in other assets pending settlements and liquidity reserves.

For the remainder of 2018, we expect group, as well as CIB leverage exposure to be broadly flat with further reductions in equities but targeted business-driven redeployment, notably in FIC.

SLIDE 11 – NON-STRATEGIC LEGACY ASSETS IN CIB

Before I move the segment results, the next two slides address a couple of special topics.

Slide 11 shows the progress we have made in reducing our non-strategic assets in our Corporate & Investment Bank.

This portfolio includes assets that are not consistent with our strategy in CIB, as well as the residual CIB assets from the non-core operations unit.



Running down these assets is one of management's priorities as we look to redeploy our balance sheet usage into higher return areas.

In the last 12 months, we decreased market and credit risk-weighted assets in the non-strategic portfolio by approximately €5 billion and cut leverage exposure by €15 billion or by more than one-third on each measure.

Leaving aside any sales or unwinds, we would expect around one-third of the current portfolio to roll off by the end of 2020.

We will look for ways to accelerate the wind-down of this portfolio where it is economically sensible for us to do so.

This was demonstrated by the sale of higher-risk parts of our shipping portfolio announced in the second quarter, which will reduce risk-weighted assets by a further approximately €800 million in the third quarter.

With revenues less credit provisions at a positive €60 million in the first half of 2018, the portfolio has not had a significant end impact on our recent financial performance.

SLIDE 12 – LEVEL 3 ASSETS

Some details of our Level 3 assets are shown on slide 12.

For ease of reference, we present some of the detail that is available in our interim reports.

We hold Level 3 assets because they are valuable in our business and valuable to our clients.

Of our €22 billion of Level 3 assets at the end of the quarter, the vast majority are generated in our core businesses. Only €1.4 billion of our non-strategic portfolio, that I just described, are Level 3 assets.

A Level 3 accounting classification is not a measure of asset quality. It signals that there is at least one valuation parameter that cannot be directly observed in a liquid market.

Our Level 3 assets are revalued continuously, both by our businesses and also through our independent valuation teams who actively monitor the input to our models, compare these with the best available market data, and assess the appropriateness of our valuation techniques.

Approximately 60% of our Level 3 assets are cash instruments, including loans and debt securities, some of which related to



less liquid markets, including in developed economies where trading volumes can be limited. They are often backed by high-quality collateral or are hedged.

The remaining 40% or €8 billion of our Level 3 assets are the positive market value of derivatives.

Derivative assets are classified as Level 3 when even a small percentage of the value is sensitive to movements in an unobservable parameter.

This often means that many of the parameters required to price these instruments are observable and these observable inputs will often be the primary drivers of the reported fair value.

Most of the derivative assets that we hold are collateralised and hedged, for example, through our €6 billion of Level 3 derivative liabilities.

Finally, as you can see on the slide, our Level 3 asset portfolio is not static, with considerable inflows and outflows.

This velocity of asset turnover is an integral part of our business model, supporting liquidity provisioning and risk intermediation on behalf of clients.

SLIDE 14 – CORPORATE & INVESTMENT BANK (CIB)

Turning to segment results, starting with our Corporate & Investment Bank on slide 14.

CIB reported profit before tax of €475 million in the second quarter on revenues of €3.6 billion.

Non-interest expenses of €3.1 billion rose by 5% year-over-year, including €175 million of restructuring and severance costs related to our headcount reductions in the quarter.

Adjusted costs of €2.9 billion were flat versus the prior year period despite the higher variable compensation costs in the quarter, as the level of deferrals normalised and we more evenly paced our accruals through the year.

And, we cut leverage exposure by €86 billion or 8% on a reported basis in the quarter, principally as a result of our announced reductions in equities and rates.

In doing this, we have increased the efficiency of our balance sheet and reduced low-yielding assets.



SLIDE 15 – CIB BUSINESS UNIT REVENUE PERFORMANCE

Turning to our revenue performance in CIB on slide 15.

Global Transaction Banking revenues increased by 4% year-over-year, principally driven by a €57 million euro gain on an asset sale.

On a sequential basis and excluding the gain on sales, transaction banking revenues increased by 4%.

Looking forward, we expect GTB revenues to increase sequentially from the underlying second quarter level, reflecting the mandates won in the second half of 2017 and thereafter.

In Origination & Advisory, revenues increased 2% year-over-year and were 20% higher than in the first quarter. Greater focus on our core product areas has allowed us to regain market share in the quarter despite the overall corporate finance industry wallet being down by approximately 10% in euro terms.

In Fixed Income Sales & Trading, revenues declined by 17% versus the prior year.

The decline was principally driven by lower credit revenues, given a strong prior year period comparison and slower revenues in flow trading, given spread-widening, while our credit financing businesses continue to perform well.

Rates revenues were down in Europe from lower volatility and decreased issuance levels but we saw improved flow in our FX and rate business in Asia/Pacific. And, finally, our FX revenues were slightly lower but with solid performance in derivatives.

Equity Sales & Trading revenues declined by 6% year-over-year on a reported basis and 4% excluding FX, driven by a decline in derivatives and cash revenues.

Prime finance revenues were significantly higher, driven by higher margins and higher revenues from the ETF, index and certificates business.

SLIDE 16 – PRIVATE & COMMERCIAL BANKING (PCB)

Slide 16 shows the results of our Private & Commercial bank.

We reported profit before tax of €262 million in the second quarter on revenues of €2.5 billion.

Non-interest expenses of €2.2 billion were broadly flat versus the prior year period as net releases of litigation provisions



offset the higher investments associated with the merger in Germany.

Merger related costs were approximately €65 million this quarter and approximately €100 million in the first half of 2018 and were the main driver of the 4% increase in adjusted costs in the quarter.

SLIDE 17 –PCB BUSINESS UNIT REVENUE PERFORMANCE

As shown on slide 17, revenues in Private and Commercial Business (Germany), which includes the former Postbank and Deutsche Bank businesses, increased by 4% year-over-year.

The increase was driven by the absence of contra revenues recorded in the second quarter of last year from the termination of a legacy trust-preferred security.

Excluding this item, revenues declined by 3% as we grew mortgage and a commercial loans to partially offset the continued margin pressure on deposit revenues and lower income from interest rate hedges.

In our continuing International operations, principally in Italy and Spain, revenues declined by 5%.

This decline was driven by the absence of a small gain on a sale in the second quarter last year as we grew loan revenues to partially offset the impact of lower deposit margins.

Wealth Management revenues, excluding a lower contribution from gains from legacy positions in Sal. Oppenheim, were broadly flat despite a negative impact from FX movements.

We saw good revenue growth in Asia on strong capital markets activity and loan growth, which offset the impact of difficult conditions in EMEA.

SLIDE 18 – ASSET MANAGEMENT

Slide 18 shows the results of Deutsche Bank's Asset Management segment which includes certain items that are not part of DWS's financials.

Asset Management reported profit before tax of €93 million in the quarter after non-controlling interests of €26 million.

Reported revenues declined by 17% versus the prior year period, driven by a €57 million decline in performance fees.



This reflected one alternatives fund that recognises fees every other year, as well as lower management fees in active and alternatives, driven by lower assets under management, net outflows, margin compression, and the absence of revenues from businesses exited in 2017.

On a sequential basis, revenues in Asset Management increased by 3%, mainly reflecting higher performance fees and investment gains in alternatives.

Non-interest expenses were essentially flat year-over-year as reductions in performance-related compensation and administrative costs were offset by higher MiFID-related external research spend and litigation provisions.

Asset under management of €692 billion increased by €14 billion in the quarter, driven by favourable market performance and FX movements.

We recorded a net outflow of €5 billion, as inflows in passive were more than outflows in cash, fixed income and equities.

SLIDE 19 – CORPORATE & OTHER

Turning to our Corporate & Other segment on slide 19.

C&O reported pre-tax losses of €119 million in the quarter including €113 million of valuation and timing differences and €118 million of shareholder expenses.

Shareholder expenses were elevated due to restructuring charges, but excluding these charges, were slightly improved relative to the first quarter level.

SLIDE 20 – PROGRESS TOWARDS NEAR-TERM TARGETS

To summarise, slide 20 reiterates our near-term financial targets.

As Christian said earlier, our main focus is on generating a return on tangible equity of greater than 4% in 2019 which we view as a realistic first step towards our longer-term aspirations.

With a return on tangible equity of 1.8% in the first half of the year, we need to improve profitability in the coming quarters to reach our target.

To support our return goals, we have introduced adjusted cost targets, including the €23 billion target for 2018.



To achieve this goal, we intend to manage down adjusted costs on a sequential basis in the coming quarters.

Of course, our €22 billion adjusted cost target in 2019 requires us to continue on this glide path.

To support our cost objectives, we will reduce headcount to below 93,000 employees by the end of 2018, and to well below 90,000 in 2019.

We've made significant progress towards the 2018 target by reducing headcount by 1,700 this quarter.

With that, let me hand over to James Rivett to moderate the Q&A session.

James Rivett

Thank you, James. Mia, if we could open up the lines for questions.

QUESTION & ANSWER SESSION

The first question is from the line of Kian Abouhossein with JP Morgan.

Kian Abouhossein

Yes, thank you for taking my questions.

Two questions, if I may. One is, can you just talk a little bit about the global market trends, both fixed income and equities, as you're seeing the progression into the third quarter, considering that your percentages are probably, in terms of year-on-year change, a bit weaker than your peers?

How do you see your performance at this point?

And, the second question is a more top-down, more strategic question.

You're the fourth to fifth largest fixed income house in the world when I look at your CIB revenues and fixed income.

You're one of the biggest transaction banks and we clearly have the cost income of historic transaction banks that you used to give.

I just don't understand why the ROE should be so low considering your scale, and I'm just trying to understand in CIB, what am I missing in terms of ROE generation.



Is there some kind of a problem in the cost base that needs to be reduced significantly more or is there anything else that is impacting the low ROE, considering you're the fourth/fifth largest player in fixed income and one of the biggest transaction banks in the world and equities, frankly, doesn't consume any capital?

Christian Sewing

Hi, Kian, it's Christian. Thanks for your question. On your first one, on the global market trends,

I think, first of all, we really would like to see the longer-term and I think it's not right for us to always comment on a weekly or monthly basis on trading trends we see.

And, please don't misunderstand that. That doesn't mean anything negative or positive.

I think we have a clear target for 2018 and for 2019, and, therefore, we are viewing this as longer than just a trend in this month or in the next months.

Secondly, if you look at the markets, and like James just pointed out, second quarter, third quarter, I think we have done the adjustments which we needed to do in the second quarter.

We are now coming from a very material and good capital base and we will redeploy part of that in order to grow the core business, in particular also in the FIC business, in the transaction bank and within the FIC business, in particular also in the credit trading.

So, I think we have very good revenues opportunities there, but we want to go away from weekly or monthly trends in that area.

James von Moltke

And, Kian, it's James, just to answer on your CIB ROE question.

I think it takes a little while to unpack all of the relative positions and levers, but our approach is we need to work on all the parts of the equation; so stabilising and growing revenues in FIC; managing the expenses down, both in front office, as we've done this quarter, and also in the infrastructure areas that support the business.

Part of it is a business composition comparison between us and our peers, part of it is also geographic.

But, we think, as we manage these levers, we can drive significant operating leverage in the business and that operating leverage, with good stewardship of our capital, can drive much better returns out of our CIB franchise.



Kian Abouhossein May I just ask on CIB, I mean, ultimately, not even looking today or two years out but long-term, and I'm sure you've done this exercise, how many people do you actually believe you need to run CIB?

 You have around 35, let's say 37,000 people roughly right now.

James von Moltke Well, there are two measures that we disclose; one is what we call the front office and the second is infrastructure.

 And, I'd say, again, we want to make sure we're efficient in terms of our footprint and the focus of the resources that we deploy against our client franchise in the front office and we need to work to make the infrastructure support the back office as efficiently as possible.

 We've invested significantly in driving that efficiency. We've also been investing in the controls and regulatory remediation in the area supporting CIB.

 Frankly, over time, as the benefits of some of those investments begin to come through, we think we can significantly improve the personnel or the head count efficiency of the business, leveraging more and more technology.

 That's a process that's underway, and it's one of the things that gives us confidence in the future in terms of both the cost base and the personnel intensity of the business.

Kian Abouhossein If I may just follow-up on the first one, on Christian's answer, because we can't really see how much of your revenue decline is from deleveraging versus market levels, would you say you have stabilised market share, because, clearly, deleveraging will have had one impact?

 Just stripping out deleveraging, from your perspective do you believe you have stabilised your market share levels in fixed income and equities?

Christian Sewing Yes, I think we can say that.

 Also, to your indirect question, the deleveraging actually did not have a material impact on the Q2 revenues.

 If you take the prime finance reduction on the leverage side, I think we have done it in a very smart and intelligent way, also due to re-pricing, that actually prime finance is up despite the leverage reduction.



And, hence, the leverage reduction does not have a material impact on the revenues.

And, on the market shares, I think we stabilised there and now have the growth opportunities, given our capital level.

Operator

And, the next question is from the line of Giulia-Aurora Miotto with Morgan Stanley. Please, go ahead.

Giulia-Aurora Miotto

Hi, good morning, and thank you for the presentation. I have a couple of questions.

The first one is about the non-strategic portfolio that you have highlighted on slide 11.

I'm interested in the PBT impact of those assets. Could you please disclose that because that would help us understand what the core business makes?

And, then, my second question is, with regards to leverage.

The progress has been significant in the quarter, €85 billion. From here, can we expect more, so towards the €100 billion target and even further or should we expect now the balance sheet to start growing because you deploy some capital towards growth? Thank you.

James von Moltke

Sure. Thanks, Giulia.

On the profitability of the non-strategic assets, what I want to reiterate is the disclosure I provided, which is in the first six months of this year, the revenues from those assets less credit provisions, so if you like, a net credit result from the assets, was positive €60 million.

And, that is more or less what you can expect from this asset portfolio. It throws off a small yield. And, frankly, gains and losses in the portfolio are likely to be more episodic than regular.

But, we're managing it, as we say, for a runoff and where we see opportunities to sell down and accelerate and it's economically sort of sensible to do so, we will do that.

But, broadly speaking, that business is neutral or those assets are neutral to the company's performance.

On leverage, we're obviously very pleased with the progress that we made in the quarter.

Broadly speaking, again, we would want to stay more or less flat to these levels. We will continue to look for efficiencies.



A significant amount of what we achieved in the quarter related to just an intense focus on that leverage balance sheet and we would expect that focus to continue as we go through the coming quarters.

That said, and as Christian highlighted, the more rapid and expected reduction in leverage exposure does give us the opportunity to recycle some of that balance sheet usage where we see good opportunities.

Operator

And, the next question is from the line of Jeremy Sigeo with Exane BNP Paribas. Please, go ahead.

Jeremy Sigeo

Morning. Thank you. I've got two questions on slide ten concerning capital. The first one was on this point about the leverage exposure coming down, so as the slide shows from €1,409 billion to €1,324 billion as a quarter-end number.

Can you give us the quarter average leverage exposure numbers for Q2 and Q1, because I'm just interested to know how that moved during the quarter? So, if you could give us the quarter average for Q2 and Q1 on leverage exposure, that'd be really helpful.

And, my second question, also on that slide, was could you talk a bit more about the two gains in CET1 capital, the €0.3 billion in DWS and the €0.3 billion other? If you could just explain a little bit more about what drove those and how sustainable those are, etc.

James von Moltke

Sure, happy to. Listen, we don't disclose on a daily average basis the leverage exposure.

What I could tell you is that it was, if you like, rateable through the quarter. So, we made from the third quarter end level, I think, progress in each month.

And, the progress was probably more accelerated in June than it had been in April and May. I'd say that the quarter-end print was probably a lower print than we might have expected because, among other things, cash was actually a little lower than we had expected at the very close.

That's natural that at the close of the quarter, there'll be often either large inflows or outflows depending on what clients are doing.



So, I would say that the quarter-end print in areas like that were a little bit lower than the average, but what I'd say in short is we made steady progress through the quarter.

And, to Giulia's question, we would intend to more or less run at this level and look for efficiencies.

In terms of the gains in the numerator of the CET1 ratio, the 0.3 that you asked about, we called out in the last quarter that for regulatory capital purposes, where there was a difference from financial accounting, the benefit of the move of the final legal entities into the DWS public subsidiary was recognised in Q2. So, that was the driver of the 0.3.

And, in the other items, there's lots of things that move in and out there, but the biggest driver in the quarter was the recognition of equity compensation in the equity accounts in the quarter. And, that, again, goes up and down modestly each quarter.

Jeremy Sigee

So, on both of those numbers, the expectation is that what has been booked stays so it's there and it remains, but you wouldn't at this point expect further movements of that kind in either of those two headings in Q3, they were just a Q2 phenomenon?

James von Moltke

The DWS is absolutely part of our ongoing capital base, for sure.

In OCI and equity comp, there are variations that take place each quarter. We obviously manage those variations carefully.

The equity comp is just based on awards and vesting schedules and that's foreseeable to us. OCI is obviously less foreseeable, but, again, something that we manage carefully across the balance sheet.

Operator

Next question is from the line of Jernej Omahen with Goldman Sachs. Please, go ahead.

Jernej Omahen

Yes, good morning. Good morning from my side, as well. Can I start on page 23, where you give the cost breakdown. It seems to us that the ability of Deutsche Bank to meet its profitability targets essentially stands and folds on the ability to deliver the cost cuts.

So looking at the IT cost line here in particular, it's down sequentially, it's down a bit year-on-year. We just had a couple of your peers report an increase in their IT guidance for this year and for next.



And, I was just wondering to what extent do you feel that you're in control of the IT cost line, as well? And, what's the probability that we sit here in two/three quarters and that number is significantly higher? So, that's question one.

Question two is on CCAR. Deutsche Bank was singled out by the Federal Reserve in that test, and I was wondering how ambitious is the timeline to try and pass CCAR on a qualitative basis?

Is that something that you think is already achievable next time around or is it a two-CCAR cycle prospect?

And, the final question is on the rating agencies downgrade. I think it was good to see that the deposit base, in particular, remained stable in the aftermath of the downgrade. And here, a question, do you think that the cycle of rating agencies downgrades is over or do you anticipate any further moves by the major rating agencies over the course of this year? Thank you.

Christian Sewing

Let me start with the CCAR question. First of all, we were very pleased with the quantitative results. I think that underpinned and demonstrated the strength of our balance sheet, strength of our capital ratio. We were happy with that result.

On the qualitative side, and you will understand that we will not talk in detail about our regulatory relationships but rest assured that we think we have done a lot of progress already on those points where we had deficiencies and where we have done a lot of progress, and we know exactly what we need to do over the coming months to overcome this one.

At the end of the day that is obviously not our decision, but we feel confident that we take over the next months the right steps to also overcome those last points, which we still have.

James von Moltke

And, on the two items on IT costs and rating agencies. On IT costs, it's something that we focus on and work hard to manage. As you point out, there have been movements in the line sort of between about €900 million and €1 billion, on a quarterly basis, and that really depends on what's going on in terms of projects that roll on or roll off in that IT estate.

We manage it carefully inside that. There is some degree of production support where we work to drive efficiencies each quarter.



There are new application developments and investments that we're making and, there, the focus is really to have as effective a programme management and delivery of IT as possible.

As I think a lot of the folks listening to this call will know, the urban legends are IT projects can be highly efficient and capable in delivering their objectives, and on the other hand, they can be inefficient. And, so, we're very focused on managing to the results of the IT investment spend.

And, then lastly, there's the amortisation and depreciation of both internally developed software and hardware and that runs on an unpredictable schedule but is also something that we're aiming to manage carefully.

If I bring that altogether and I think really the thrust, Jernej, of your question is do we feel we have enough resource dedicated to IT. I think if you look at a bottoms-up, there's always more demand for IT than perhaps an ability to spend.

But, from the top-down, we're focused on the management disciplines of driving the greatest efficiency and effectiveness from that IT estate and, over time, working through significant projects that we have initiated over the past several years.

And, frankly, we're making tremendous progress. If we look across a number of those initiatives, we're seeing sort of near-term benefits and longer term strategic improvements that come from that IT investment.

On the rating agencies side, obviously it's hard to speak about our dialogue on sort of a public call with the rating agencies. I'd say two things; one is, obviously, after the S&P actions earlier in the quarter, we were very focused on our communications with our clients, on ensuring that they understood the rationale behind that move which was focused on the restructuring of the bank.

And, so, I think the agencies are communicating to us that they want to see quick action in terms of restructuring and driving sustainable improvements and we think we've demonstrated and delivered on that this quarter.

But, I think the clients, on the whole, were comfortable with the position of the bank and the progress that we're making and so we were very pleased overall with that communication and the trends.



And, as you saw, really all of our liquidity measures are as strong or stronger than they were at the end of the first quarter.

As to the future path, as you probably know, we're on watch for Moody's with our non-preferred rating and that we see as mostly a technical adjustment reflecting the German bail-in legislation environment.

And, so the good news is we do expect that legislation to become effective shortly, enabling us to issue senior preferred debt. The bad news is that, in Moody's rating system, that will likely to result in a technical downgrade of the non-preferred.

As we've said on this call and the fixed income call over the last several quarters, we are absolutely focused on changing the direction of our ratings because we think it's a sort of essential competitive element here in improving our funding costs and, overall, our competitiveness.

Jernej Omahen

Thanks very much. James, just a very short follow-up. So, on the IT spend, Deutsche feels that you're in control of that line item. You don't think that big surprises are likely? Because the reason why I'm just following up on this is because, with this, you seem to be bucking the trend for your peer group in Europe and the US.

James von Moltke

It's very hard to get underneath what peers are doing, Jernej, in terms of their IT spend. We are working through an investment programme across the bank, and within that, working hard to manage this line item carefully; very focused on it.

Operator

The next question is from the line of Andrew Stimpson with Bank of America Merrill Lynch.

Andrew Stimpson

Morning, guys. Thanks for taking my questions. I've got two here. First one, to come back on the IT cost issue. When you came up with the new strategy, you said you'd actually be cancelling some IT projects. From the answer you gave before, it does sound like maybe you have cut some of those projects. So, I'd just like to know what kind of projects you've cancelled and whether that was contributing to that?

And, James, you said there that you were managing the amortisation of capex. Does that mean that you've decided to extend the amortisation schedule over a longer timeframe? And, I remember before on technology progress, you used to give a few KPIs I believe in the past you said you'd continue to



give us on things like intersystem reconciliations, migrating to the cloud.

If you are using those, I'd love to get an update. If you're going to use different ones, I think that'd be helpful for us to get those in a quarterly basis, as well.

If I can be cheeky and group all of that into one question and then come on to prime.

You've cut the balance sheet in equities by €40 billion. The equities revenues actually did well and you said earlier, as well, that actually the deleveraging didn't have much of an effect on revenues. Is that just a timing issue? Is there going to be an impact next quarter or why does leverage not affect prime revenues? I'm a bit confused on that.

James von Moltke

Sure, and thanks for the questions. Absolutely, there were IT projects cancelled. We are working hard to focus on, really, two areas and those are regulatory remediation and preserving an innovation budget, given obviously that we and our competitors are investing to ensure we remain competitive in a changing environment.

In particular, we looked at projects where, again, as I said earlier in answer to Jernej's question, the delivery of the project wasn't meeting a set of metrics and standards that we wish to apply to them.

I don't want to go into specifics of which projects – it's a little bit granular – but, we revisited the prioritisation of our IT projects and made judicious decisions about where to continue to invest.

One other thing that I'll mention is, as it relates to this amortisation, one of the reasons for the slightly elevated IT costs in Q1 were some impairments that we took.

And, so, when I think about the amortisation line, it's making sure that the assets on our balance sheet are productive and delivering the benefits that we expect from them. If they're not, you'll see additional impairments .

So, hopefully, that gives you some colour.

Andrew Stimpson

Okay.

James von Moltke

In terms of the metrics, we can certainly provide those metrics. We do continue to track them internally. We've talked about we're managing the company with scorecards and so those are



metrics that we review with the businesses and with Frank Kuhnke, our COO, every month.

So, if I give you a couple of items; private cloud adoption is now at 38%; operating systems, the current number of systems in use is 27; our end-of-life technology continues to improve; and intersystem reconciliations were about 1,000 in 2015, we're now below 600.

So, to give you some sense, A, that we're continuing to track them and, B, that we're making progress.

Christian Sewing

Andrew, before I come to the prime equities, if you just think about now what we have achieved with the legal entity merger in Germany, Frank Strauss and his team are looking in a very disciplined way in looking into the IT budget for both Postbank and Deutsche Bank Retail & Commercial Bank, and I know that they have reduced because there were duplications.

Now, with one management, with one platform, with one person responsible for both, obviously you see things which you can cut to previous year and therefore that is just one more example where, I think, we are more disciplined. We can take efficiencies without losing sight of the necessary IT spend.

On prime, your question: cutting balance sheet and whether this has an impact on future revenues. I think we have shown already, also, in Q2, again, that actually revenues hold up very well, actually increased because of the way we reduced the leverage.

It was done, I think, in portfolios where we had very, very low yields. So, we did it there and we obviously did also a good job in repricing this portfolio. Going forward, I do not expect that those cuts in prime equities will result in lower revenues.

Andrew Stimpson

Okay. Thank you.

Operator

Next question is from the line of Andrew Coombs with Citi. Please, go ahead.

Andrew Coombs

Good morning. I had one follow-up on the leverage exposure reduction and then another question on the CIB outlook.

On the leverage exposure reduction, I think your point was that you've achieved what you set out to do faster than expected. You therefore expect to keep the leverage exposure flat going forward and recycle some of the balance sheet usage.



What I'd be interested to know is of the €114 billion reduction on an FX-neutral basis, how does that come out by region? I'd assume a lot of it does relate to the US and, if so, how much ability do you have to repatriate capital, if any, to the group?

Second question: on CIB, at the top of page 27 of the quarterly report, you state that risks to your outlook include the impact of MiFID II, the potential impact of Brexit, as well as future impact of Basel III framework agreement. Could you just elaborate a little bit more there on what you perceive the risks to be to your top line in CIB from those items? Thank you.

James von Moltke

Sure. Thanks, Andy. So, on the leverage exposure, the repo reduction was more oriented towards the US, and that is in rates, which is part of FIC, and again that reflected the strategic decisions. On prime finance, it was more evenly spread.

As a result, the sort of geographic distribution of the leverage exposure was probably more even than you'd expect. It also reflects the booking models that we have for those businesses. So, there was a focus in the US, but it was reasonably evenly distributed across the group.

In MiFID, we are obviously tracking as carefully as we can the impact of MiFID. Obviously, it's easier to see on the cost side. So, for example, DWS have about €20 million of increased expenses in the first half associated with MiFID.

In PCB, we see pretty significant MiFID implementation costs in the first half, although some of those should abate over time. What's harder to see is what the revenue impact of MiFID is because you're tracking, essentially, customer behavior at a very granular level.

If we were to guess, in PCB, it would be certainly in the tens of millions of euros so far in the first half, so I'd say somewhere between €30 million and €50 million that we may have given up in terms of reduced client engagement. In CIB, frankly, it's harder to track, but not zero.

Andrew Coombs

And on the Basel, I think it's obviously difficult to quantify – but on Basel III framework agreement, what does that specifically relate to now? Is that the Basel III revisions being phased in over the longer time frame that you're drawing out?

James von Moltke

As we've said before, we're looking over a ten-year horizon with respect to Basel III final framework. There's still a lot of uncertainty that the industry faces around, first of all, the results



of a quantitative impact study; secondly, how the Basel III framework is transposed into European law and a number of national exemptions and other features of Basel III.

So, frankly those uncertainties make it hard to plan against, we clearly build the Basel III framework into our return calculators, and we build into our plans our best estimate based on the assumptions of what the likely implementation will look like.

Andrew Coombs

Understood. Thank you very much.

Operator

And, the next question is from the line of Stuart Graham with Autonomous Research. Please, go ahead.

Stuart Graham

Morning. . Firstly, back on the revenue attrition question. I hear what you say about very little in Q2 and you don't think there's anything in prime finance, more generally.

But, there must be something to come in rates and in equities, more generally because, clearly, you didn't cut all the staff or cut all the leverage ratio exposure on the first of the quarter. So, what do you expect in rates and equities, more generally, revenue attrition for H2, please?

And, then, the second question is on compensation accrual. You say you've changed to be more, even over the quarters. What exactly changed versus previously and what would your H1 comp costs have been if you hadn't made that change? I'm trying to get a sense of how material this is? Thank you.

James von Moltke

Sure. Thanks, Stuart. So, on the revenue item, here I'll maybe draw your attention to some math. What we provided in the June 6 presentation in the lower-yielding balance sheet, of which clearly prime and repo within rates was part, was a yield of about 42 basis points. Now, that's obviously a blend.

But if you applied that, the €80 billion leverage exposure reduction in those two businesses would translate into a little bit over €300 million of foregone revenues on an annual basis, and that splits, I think, reasonably evenly between the two.

As you point out, I think the repo revenues, in US rates, there's not really any offset to that. So, I would see that €150 million, a deadweight revenue loss. We think that's good in terms of the returns to shareholders that, that balance sheet can deliver applied to higher-yielding opportunities.

And in prime, as Christian said, a number of elements of how we're managing that franchise, the efficiency of leverage



exposure usage against client balances where, as we've demonstrated, there are efficiencies that can be achieved, as well as benefits from repricing.

So, there are significant offsets in prime, whether it's every euro on a net basis remains to be seen, we're relatively early, but that certainly describes our current expectations for the prime business.

Stuart Graham

I'm sorry, you're cutting in non-European ECM and M&A. I mean, clearly those are not great businesses, but they did deliver some revenue. So, there's some additional revenue leakage there, isn't there?

James von Moltke

Yes, and there, in European rates, what we saw was, frankly, a more difficult market in the second quarter. So, you have to wash out a little bit our own actions from the market environment, but I'll just remind you, for us, European rates is core. It's an area where we will continue to invest and deploy the balance sheet.

On the compensation side, it's hard to say. You will recall that we had a significant increase in compensation in the fourth quarter last year – was €500 million or so year-on-year – and clearly reflected that the comp decisions that we made at the very end of last year had not been rateably included throughout the year.

So, if you take some portion of that and spread it over the year 2017, you can make some estimate of how the year-on-year variances in 2018 have suffered. So, as we sit here in 2018, we're building accruals towards an expectation of performance-related variable compensation.

Because it's rateable, it's creating some degree of year-on-year variance. This quarter, that performance-related piece is about €70 million of year-on-year pressure. I wouldn't say all of that is simply the shift of accruals from Q4 last year into other quarters, but certainly some of it is.

Stuart Graham

Sorry, that €70 million is a Q2 figure or an H1 figure?

James von Moltke

That €70 million is a Q2 figure, year-on-year.

Stuart Graham

Got it. And, when you're rateably budgeting this, you're, I guess, assuming... I mean, in your outlook statement, you say FIC will be slightly lower year-on-year, equities slightly lower; so, those are some revenue assumptions you're using to drive the comp accrual, is that right?



James von Moltke Yes, and our plan expectations. So, in each quarter, it's a combination of our plan expectations, performance-related adjustments and then, of course, we'll make final decisions at the end of the year. But, we think we are accruing responsibly this year against our performance expectations for the full year.

Stuart Graham Thank you for taking my questions.

James von Moltke Incidentally, Stuart, just to give you the last piece, for the first half, that same number, the €70 million in the second quarter will be €110 million in the first half, again, a rateable accrual.

The other piece, is about €70 million again in the second quarter, is the impact of higher deferrals from prior years. You'll recall that 2016 essentially is a low point and so there's a catch-up in terms of the recognition of deferred comp expense.

Stuart Graham Got it. Thank you.

Operator Next question is from the line of Amit Goel with Barclays. Please, go ahead.

Amit Goel Hi, thank you. Also, just following on the commentary on the outlook in the interim report, just trying to understand, so obviously these expectations on the outlook are driving some of your expectations for the return profile next year and beyond.

Still trying to reconcile, for example, things like sales and trading, FIC revenues where you say to be slightly lower in 2018. I mean, it suggests, depending on what you mean by slightly lower, a very strong pickup in the second half despite the cuts that have been made.

So, just really trying to understand a bit better what goes into those outlook statements and obviously that's still a little bit weaker than what you said last quarter. So, just your kind of conviction around that and why, for example, here in FIC in the second half it should be a strong uptick. Thank you.

James von Moltke Sure. Amit, the performance so far is running very much in line with our expectations or certainly a range of expectations against our planning and our thinking in the first half of this year around reshaping the CIB franchise.

As we think about the outlook, of course, that compares to last year's third and fourth quarters where, as you'll recall, volatility in the marketplace was very low, sort of unusually low across many of our stronger business areas.



And, so part of the expectation is a continuation of still muted volatility that you've seen this year, although better than last year. And, so that volatility or market environment expectation somewhat compensates for the reduced perimeter in our businesses.

Amit Goel Okay. Thank you. But, I mean, if you were to see the same result in FIC that you had in Q2, in Q3 and Q4, you're still going to be struggling to get to that guidance or that outlook.

Christian Sewing Let me take this one. I think you have to also recognise with the transformation we have done in Q2, obviously there is an impact next to all the normal market developments on our franchise.

And, now, coming from a position that we can redeploy resources, which we reduced in other parts and redeployed, in particular, in our core businesses, and one of them is FIC and rebuild a pipeline which will drive revenues going forward.

So, in this regard, I think it is potentially not right just to think about Q2, and from that, extrapolating into Q3 and Q4. We have capital available. We have, clearly, the client franchise.

And, if I look at our own plan, if I look at the feedback we get from the business, we're optimistic that we can generate business. We have the franchise, we have the capital, and with the transformation largely well underway in CIB, I think we can focus on the business in Q3 and Q4, and that makes us optimistic that we can pick up.

Amit Goel Thank you.

Operator Next question is from the line of AI Alevizakos with HSBC. Please, go ahead.

AI Alevizakos Hi, good morning. Thank you for taking my couple of questions. So, even though it seems to me like you're focusing more on reducing the leveraged assets, you don't give anymore a specific target on what's going to be the new leverage target and you only give like that 13% core Tier 1 capital ratio. So, is the number now changing assuming that your investment bank, your new investment bank is going to be slightly smaller compared to the past?

And then, secondly, just a clarification on the ROTE target of more than 4% for 2019, first of all, does the 10% still apply for the years after? And, then, secondly, that 4% includes the AT1 coupons? Or is it excluding the AT1 coupons, which are not going through the P&L? Thank you.



James von Moltke

Thanks, AI, for your questions. So, as we've said, our expectation now is to manage to a leverage balance sheet more or less at the current size, but we'll continue to look for efficiencies as we go forward. The leverage ratio targets that we have operated under remains applicable. So, it's a medium-term or longer-term target of building to 4.5% over time, and both numerator and denominator changes is how we think about achieving that.

The ROTE target over time is absolutely something that we are continuing to focus on and build to. But, as Christian said in his introductory comments, we feel like the 4% as a milestone and proof point that we are on track towards those longer-term levels is how we wish to operate. And, the final question related to the AT1 coupons, yes, it is before the AT1 coupons as we currently measure it.

AI Alevizakos

Sorry, just a follow-up. Do you really need the 4.5% leverage ratio right now or could you just get away with a 4%, given that kind of your aspirations have actually been a bit lower compared to the past?

James von Moltke

As we've talked about, we've always been comfortable with our leverage balance sheet. Often, as we've talked about, leverage is a blunt measure. We think our balance sheet is somewhat different to peers in terms of the risk content of that leverage balance sheet, hence, our degree of comfort with our leverage ratio.

That said, it's been our articulated goal to build over time and we think the 4.5% is a sensible level, particularly as the G-SIB surcharge enters into the minimums over time. I'd point out as well, though, that our 4.5% is at least measured today against a phase-in ratio level.

So, we talk about our fully loaded at 4%, the phase-in is in fact at 4.2%. That level includes some capital instruments that are grandfathered in the phase-in approach, but not in fully loaded. So, our gap to our medium-term target is not as wide as the 4% to 4.5% would indicate.

AI Alevizakos

Fantastic. Thanks very much.

Operator

Next question is from the line of Andrew Lim with Société Générale. Please, go ahead.

Andrew Lim

Hi, morning. I've got a few questions, please. So, on page nine of the financial report you talk about prime finance and you talked about how the strength there is in part due to inventory gains. I



presume this is due to closing client balances as you've delevered. I was wondering if you could quantify how much these gains were. And, then, secondly, you talked about day one profits – it seems to seem to be a theme this quarter – on page 12 of the presentation. Could you talk about how these have arisen and, then, also talk about how these are treated on an accounting basis? I presume none of this comes through the P&L and it goes through OCI. And, then, also, could you confirm that it contributes to your CET1 capital?

And then, thirdly, you've talked before about an impact on CET1 capital in the past to come from certain items that you've previously flagged, such as the contribution to the guarantee fund. Could you give a bit more specifics about whether there's more impact relating to these to come in the second half of the year? Many thanks.

James von Moltke

Sure. So, what we refer to as inventory management our interim report, that is the ETF certificates and index piece in the prime finance business that I mentioned in my remarks, so essentially facilitating client transactions where index positions remain on our balance sheet for a period of time and those can drive benefits.

That represented a little over half of the year-on-year improvement in prime, the rest was driven by essentially margin on client financing. Again, positive performance on those two sides of the prime business.

As it relates to the day one P&L, there are 2 elements that we call out, out of conservatism in how we capitalise those Level 3 assets. One is PruVal, which is a CET1 deduction, so that is a capital item and not a P&L item.

The day one P&L is simply withheld profits, so the net present value of a position on inception would generally, under IFRS, generate a day one P&L. We hold some of that back to reflect conservatism, discounts for illiquidity, the margin requirements on the portfolio and other adjustments.

And, day one P&L is not recognised at inception of the transaction. When there's an event, either because the transaction is unwound or sold or because a degree of certainty came into the original uncertainty, then that day one P&L can come back into our recognised financial statements.

In terms of the numerator on CET1, look, there, as I mentioned in OCI and equity comp, there are items that will vary over the



balance of the year. Because we're not recognising net income into CET1, the presentation is actually a little bit conservative.

So, there's about 15 basis points of net income not currently recognised in our CET1 ratio, but we don't see those on the whole as a significant driver. Where we can control the CET1 inputs, we obviously do. It's part of managing to book value or tangible book value per share improvements over time. So, for example, FX in the CET1 ratio is something that we manage.

But, nothing significant in our forward-looking outlook that we would call out beyond, as I've referred to in the last couple of quarters, changes in regulation that we're monitoring and engaging with our regulators on. But, as I pointed out relative to earlier in this year, those changes appear to have both receded in time and diminished in terms of the expected impact of those items.

Andrew Lim

Sorry. On that point, so the deferred day one profit of €0.4 billion, that actually goes through the income statement, your reported income statement?

James von Moltke

Yes, over time as those items, as the transactions roll off, it would roll off of the income statement.

Andrew Lim

Oh, so was that the case in the second quarter or is that to come going forward?

James von Moltke

It's not something that is a major move in any given quarter, necessarily. It sort of dribbles out as transactions roll off. The disclosure for that is on page 98 of the interim and shows a relatively stable profile versus the prior year.

Andrew Lim

All right. I'll follow up on that. And, sorry, and regarding the last question?

James von Moltke

Again, a natural part of the business that we do disclose.

Andrew Lim

And, sorry, do you have any comments on further impacts on the CET1 capital for the second half of the year?

James von Moltke

I think I answered it.

Andrew Lim

Right.

Operator

And, the next question is from the line of Anke Reingen with RBC. Please, go ahead.

Anke Reingen

Thank you for taking my question. I'm just trying to understand how Q2 can be seen as a run rate given the restructuring announced late into the quarter. And, I just wanted to confirm the €300 million on lost revenues, that's off the Q2 revenue base or would you think a part of this is already in the Q2 number reflected?



And, then, on the costs, clearly I assume the Q2 comp numbers include a number of people that actually now have left your payroll. So, is it right to assume in order to meet your cost targets general expenses are sort of like flat and the biggest delta comes from the reduction in compensation expenses? Thank you very much.

James von Moltke

So, a few things in that. First of all, the €300 million that I mentioned in answer to Stuart's question was an annual number and I'd think of that not against necessarily the 2Q but look at annual revenues compared to 2017.

And, as Christian highlighted, some amount of that €300 million we would expect to offset through just performance improvements in the businesses, including repricing and efficiency.

As we look forward on the expense line, we are working hard to have both compensation and non-compensation costs contribute to a glide path of quarterly expenses that moves us to achieve our targets over time. We've talked a lot about the bonus and retention elements of compensation and benefits recognition that are creating a headwind in terms of our expense picture.

But over time, the benefits of headcount reductions, we would expect to see compensation costs begin to decline. In fact, in just the salary and benefits element of our compensation accounting, quarter-on-quarter we had a relatively significant decline of €50 million – that's second quarter relative to first quarter – and we would expect continued benefits going forward reflecting the headcount reductions that took place this quarter.

Anke Reingen

Yes, thank you. If I may just ask one question in the Corporate and Other, given you moved a number of staff and costs between the divisions, is there like a guidance you can give us on Corporate & Other

James von Moltke

It's always hard to predict. The shareholder expense portion of Corporate & Other we can estimate and we've told you that that's running around €95 million a quarter and you can annualise that number. As we mentioned, there's a little bit more in severance this quarter. Severance is likely to continue in Corporate & Other over the next couple of quarters.

The other items, in particular, the valuation and timing differences, those can be quite volatile. We manage that



through hedging programs, but where there are timing differences between the accrual and the mark-to-market balance sheet, because we hedge to the economic risk, there will be some volatility running through the P&L and that is hard to give clear guidance on.

Operator In the interest of time, we have to stop the Q&A session, and I hand back to James Rivett. Please, go ahead.

James Rivett Thank you very much, and thanks everyone for joining. The Investor Relations team is around to take your questions.

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