



Deutsche Bank AG

Deutsche Bank Q2 2018 Fixed Income Call

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Transcript

Speakers:

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Dixit Joshi – Group Treasurer

James Rivett – Head of Investor Relations



James Rivett

Thank you, Mia, and good afternoon or good morning, everybody. On behalf of Deutsche Bank, welcome to our quarterly fixed income investor call to discuss our second quarter 2018 results. As usual, our CFO, James von Moltke, and our group treasurer, Dixit Joshi, will run through the presentation. Also available for the Q&A session that will follow the prepared remarks is Jonathan Blake, global head of issuance.

You should have access to the presentation on the creditor information section of the Deutsche Bank investor relations website. Please be reminded of the cautionary statements regarding forward-looking statements at the end of this presentation. With that, let me hand over to James.

James von Moltke

SLIDE 2 – EXECUTION ON STRATEGIC PLAN TO MATERIALLY IMPROVE EARNINGS AND CAPITAL GENERATION OVER TIME

Thank you, James, and welcome to you all. Let me start by updating you on the delivery of our strategy.

Our fundamental objective is to sustainably generate organic capital over time. And, our conservative balance sheet provides the support we need to adjust our franchise and to grow within our target client and product franchise where it makes economic sense to do so.

This, over time, should help us improve our credit standing and lower our funding costs.

In the second quarter, we have made progress executing on our strategic objectives. In the corporate and investment bank, we are optimizing our resources. This includes reshaping our equities business and reducing our US rates activities. And, in the second quarter, we cut leverage exposure faster than our internal targets.

In PCB, we have completed the legal merger of our German retail and commercial banking entities, which has enhanced our financial flexibility. We are now starting to extract, and even looking to accelerate, our targeted synergies.

At a group level, our cost-reduction plans are running in line with our internal targets, and we have reduced headcount by 1,700 in the quarter.

SLIDE 3 – Q2 GROUP FINANCIAL HIGHLIGHTS

Let us turn to a summary of our second quarter results on slide three, which demonstrate the resilience of the franchise, despite some of the idiosyncratic pressures we have faced.



Reported revenues were flat, year on year. Non-interest expenses increased by 1%, driven by higher restructuring and severance as we executed on our strategic objectives.

These effects were partially offset by a decline in adjusted costs and FX translation benefits.

Profit before tax was 711 million euros. Our tax rate was elevated, reflecting the non-tax-deductibility of certain expenses.

As a result, we generated 400 million euros of net income in the quarter.

Tangible book value per share increased to 25.91 euros, up 1% compared to the prior quarter, despite paying 519 million euros of AT1 coupons and dividends.

SLIDE 4 – H1 RESULTS DEMONSTRATE THE RESILIENCE OF OUR FRANCHISE

Slide four looks at the development of some key financials during the first half of the year.

Our revenues were down by 400 million euros versus the first six months of 2017, but increased on an FX-adjusted basis. I want to point out that our performance in the first half of this year was flattered by several one-off items, totaling 495 million euros.

Revenues in CIB were impacted by lower business volumes and ongoing perimeter reduction initiatives. In PCB, revenues were essentially flat as we continued the recent trend of growing loans to offset the impact of the persistently low rate environment. Lower performance and management fees were a key driver in asset management.

We were encouraged by our quarter on quarter revenue growth in origination & advisory, transaction banking and asset management, but we know that the overall franchise is capable of delivering higher revenues in the future.

In the first half of the year, non-interest expenses were up year on year, mostly reflecting higher restructuring and severance as we took measures to reshape CIB.

Adjusted costs were down by 50 million, but increased by approximately 300 million euros on an FX-adjusted basis. This increase was mainly driven by higher compensation and benefits as we look to more evenly pace accruals for variable compensation.

In addition we faced higher bank levies, IT costs, investments and merger-related costs in PCB, as well as DWS IPO-related



expenses. These effects were partially offset by our actions to reduce costs in other areas.

Litigation was a small cost in the first half of this year, compared to a provision release in 2017. Credit loss provision showed a slight improvement and remained at very low levels. As a result, profit before tax was lower than in the first six months of 2017.

SLIDE 5 – PROGRESS TOWARDS NEAR-TERM TARGETS

Progress towards our near-term financial targets is shown on slide five.

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

With a return on tangible equity of 1.8% in the first half of 2018, we obviously have work to do to improve profitability and returns in the coming quarters.

With the annual bank levies already recognized in the first half of the year, we are on track to meet our 23 billion euro adjusted cost target and are working towards a further 1 billion euro reduction for 2019.

To reach our cost objective for this year, we will have to reduce adjusted costs quarter on quarter in the third and fourth quarters, from the second quarter level.

Achieving our cost targets relies, among other things, on a significant headcount reduction to below 93,000 at the end of 2018, and well below 90,000 in 2019.

We are confident that we can achieve this, given the headcount reductions completed in the second quarter, and we will execute on these targets while maintaining our common equity tier one ratio above 13%.

SLIDE 6 – A CONSERVATIVELY MANAGED BALANCE SHEET

As I said earlier, you can see that we have been consistently conservative in managing our balance sheet, on slide six.

This provides an extremely solid basis to adjust our franchise and grow earnings. Our common equity capital is about 11 billion euros above our current regulatory requirement. We have a total loss-absorbing capacity of 119 billion euros, well above both our new MREL and our 2019 TLAC requirements.

We believe this provides a comfortable cushion for our depositors and counterparties.



Our credit as well as market risks, are low, and also amongst the lowest of our global peers, which is testament both to our strong underwriting standards and our prudent approach to trading.

With one of the lowest loan-to-deposit ratios of all European banks, and ample liquidity, we are well positioned to support our clients and capture future growth opportunities. With that, let me hand over to Dixit.

Dixit Joshi

SLIDE 8 – LEVERAGE RATIO

Thank you, James. Let us start by looking at our leverage ratio on slide eight.

On a fully-loaded basis, our ratio increased by 28 basis points, to 4%. This was driven by an 85 billion euro reduction in leverage exposure, or 114 billion euros on an FX-neutral basis.

We saw reductions in cash of 24 billion, and pending settlements of 4 billion euros, broadly offset by the impact of FX translation.

The decline in business assets was materially all in equities and FIC, principally prime finance globally, and rates concentrated in the US, as we execute on our strategic objectives.

Product-wide reductions were mostly in secured funding transactions, which were down by about 45 billion sequentially, lower trading inventory of 15 billion, and derivatives of 10 billion euros.

For the remainder of 2018, we expect group as well as CIB leverage exposure to be broadly flat, with further reductions in equities and targeted business redeployment notably in FIC. On a phased-in basis, the leverage ratio stood at 4.2%.

SLIDE 9 – COMMON EQUITY TIER 1 CAPITAL RATIO

Turning now to our common equity tier one ratio on slide nine.

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 euros in the quarter. Roughly half of the decline comes from process enhancements, and the rest from reduced business utilization, including a small contribution from the deleveraging of our low-risk balance sheet in prime finance and US rates.



As discussed in previous quarters, we have been anticipating additional regulatory charges, the timing of which appears to be extending.

As a consequence, our current expectation is that the impact of regulatory changes on the CET1 ratio within the year should be less than we previously thought, and perhaps no more than 20 basis points. We will continue to manage to a CET1 ratio of greater than 13%.

SLIDE 10 – MREL AND TLAC

Slide ten provides an update of our total loss-absorbing capacity as reflected in TLAC and the new MREL requirement.

In line with our prior guidance, our TLAC stack reduced by 5 billion in the quarter, to 119 billion euros. The reduction was driven by plain vanilla senior instruments rolling below the recognition threshold of 12 months remaining maturity.

Last month, we received a letter from BaFin clarifying our minimum requirement for own funds and eligible liabilities, or MREL. This requirement is in line with the single resolution board's MREL-setting methodology, and is consistent with our prior expectations and our funding plans.

This might be new to some of you, so let me give a bit more background.

First, what are Total Liabilities and Own Funds, or TLOF. TLOF is a new balance sheet measure used by the SRB, principally comprising of IFRS liabilities, adjusted for derivatives netting, and using total regulatory capital instead of IFRS equity. For further details of the new measure, and how the requirement was derived, I would like to point you to slide 19 in the appendix.

Let me also highlight that our 9.14% requirement is effective immediately. This is in contrast to some of our peers, where the MREL requirement is only phased in and sometimes set for 2020 or 2021.

This reflects our strong position as we already fulfil the MREL requirement comprehensively today.

As of June, we had an MREL ratio of 10.8%, which translates into a surplus of 18 billion euros. Evidently, MREL requirements by the resolution authorities in Europe have been set on a higher standard than the FSB TLAC term sheet.

Nevertheless, we will continue to report our TLAC requirement which, based on leverage, stood at 79 billion and, based on risk-weighted assets, stood at 71 billion, resulting in a 40 billion euros



surplus. We comfortably meet both our MREL and our TLAC requirements.

SLIDE 11 – 2018 FUNDING PLAN AND CONTRACTUAL MATURITIES

Turning to our funding plan now, on slide 11. As a result of our accelerated deleveraging activities we have revised down our 2018 funding plan to 25 billion euros.

At the end of June, we have completed around 55% of our updated funding plan, at an average spread of 56 basis points above Euribor.

After a very active first quarter, we slowed down the pace of our issuance activities during the second quarter, partially in reflection of the challenging markets.

Roughly two-thirds of the remaining 11 billion we plan to issue in the second half of the year will be in more senior categories, including covered, structured or preferred instruments, with the remainder in non-preferred instruments.

As you can see, our funding plan for the year now no longer includes the issuance of either AT1 or tier 2, given our lack of near-term requirements.

Let me give you a quick update on available distributable items or ADI position, which is used, amongst other things, to determine our ability to pay our AT1 coupons.

As a reminder, ADI is based on our German GAAP parent company financials which are only calculated annually, so it is not possible to give exact numbers at this stage. That said, we remain very comfortable in our ability to pay AT1 coupons in the coming years.

Our payment capacity for 2017 was 1.1 billion euros, with an additional 2.7 billion euros reserves under HGB. This covers, at a minimum, about 3.5 times the 2017 315 million annual coupon requirement.

While not directly comparable to the German GAAP reporting requirements, under IFRS, we have generated net income of 481 million euros in the first six months of the year.

Starting next year, our AT1 payment capacity is also likely to increase on two regulatory changes.

First, the legal entity merger of our retail entities, which we still expect to have a positive impact on the absolute ADI level of the group. A final determination for this will only happen at year-end, but Postbank had reserves of approximately 2 billion euros as of 2017.



Second, the potential harmonization on a European level, regarding payment capacity. The European Parliament has finalized their position on the review of the CRR. This includes a paragraph on how reserves are treated in the ADI calculation.

The European Parliament will now enter into discussions with the council, and we hope that these discussions will come to a close in early 2019, and we continue to monitor this process closely for positive impacts on our ADI calculation.

Given CRR is a regulation, it would come into force immediately without requiring national implementation.

On another regulatory topic, the legislation in Germany which allows us to issue preferred plain vanilla senior debt was effective on 21st July of this year.

We plan to make use of this funding instrument in the near term.

SLIDE 12 – NEW GERMAN INSOLVENCY HIERARCHY AND IMPLICATIONS

Let us turn to the next page to illustrate the creditor ranking and ratings of those instruments a bit better. The previous legislative framework took a statutory approach, where the ranking was determined by the specific characteristics of the note, for example plain vanilla or structured.

The new legislation in Germany harmonizes the rules with other European countries. It allows all German banks, including Deutsche Bank, to contractually designate the insolvency ranking for plain vanilla notes. In addition to non-preferred senior instruments this allows us to issue preferred senior, which has a higher insolvency ranking and will obviously have a positive impact on our overall cost of funds.

On the right-hand side of the slide, you can see the different rating of the senior bonds in the two categories. The preferred instruments are assigned a one to two notch better rating, being in the A range at both Moody's and Fitch, and BBB+ at S&P.

SLIDE 13 – EXTERNAL FUNDING PROFILE

Moving on to slide 13, you can see our external funding profile as of the end of June.

Funding sources reduced by 55 billion to 948 billion euros as we reduced our leverage. Lower secured funding activities of around 40 billion euros, primarily in equities, were the biggest driver of the reduction in the non-stable sources, while we saw a seasonal decline in transaction banking deposits of around 12 billion euros.



As a result, the proportion of total funding from the most stable sources increased to 77%. Around 55% of our funding base is from retail and transaction banking deposits.

SLIDE 14 – LIQUIDITY

Slide 14 summarizes our key liquidity metrics. Both our liquidity coverage ratio, LCR, and liquidity reserves remain stable versus the prior quarter.

The LCR stood at 147% and represents a 77 billion euros surplus above the requirement of 100%, while liquidity reserves remain at 279 billion euros.

The mix of our liquidity reserves changed over the quarter, as the proportion of securities increased relative to our cash holdings.

Although, with only 27% of our liquidity reserves in securities, we remain very liquid. This increase was partly driven by our ability to fully recognize the remainder of the Postbank security portfolio in our reserves, after the completion of the legal entity merger.

Going forward, we see additional room to reduce liquidity reserves as we further optimize our balance sheet.

SLIDE 15 – NON_STRATEGIC LEGACY ASSETS IN CIB

Before we move to the Q&A, let us look at a couple of special topics on the next two pages. Slide 15 shows the progress we have made in reducing our non-strategic assets in our corporate and investment bank.

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

Running down these assets is one of management's priorities, as we look to recycle our balance sheet 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 euros, and cut leverage exposure by 15 billion euros, or more than one third in each measure.

Leaving aside any sales or unwinds, we would expect about 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.

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



SLIDE 16 – LEVEL 3 ASSETS

Turning to slide 16 to provide more detail around our level three assets. For ease of reference, we present some of the data that is available in our interim reports.

We hold level three assets because they are valuable in our business and valuable to our customers. Of our 22 billion euros of level three assets at the end of the quarter, the vast majority are generated by our core businesses. Only 1.4 billion euros of our non-strategic portfolio within CIB are level three assets.

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

Our level three assets are revalued continuously, both by our businesses and also through our independent valuation teams who actively monitor the inputs into our models, compare with the best available market data and assess the appropriateness of the valuation technique.

Approximately 60% of our level three assets are cash instruments, including loans and debt securities, some of which relate to less liquid markets, including in developing economies where trading volumes can be limited. They are often backed by high-quality collateral or are hedged.

The remaining 40%, or 8 billion euros, of our level three assets are the positive mark-to-market of derivatives. Derivative assets are classified as level three, even when 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 present value. Most of the derivative assets that we hold are collateralized and hedged, for example, through our 6 billion euros of level three derivative liabilities.

Finally, as you can see on the slide, our level three asset portfolio is not static, with considerable inflows and outflows taking place. This turnover is an integral part of our business model as we support liquidity provisioning and risk intermediation on behalf of our clients. With that, let me know hand back over to James Rivett to moderate the Q&A session.



QUESTION AND ANSWER SESSION

- Operator And the first question is from the line of Lee Street from Citigroup.
- Lee Street Hello, good afternoon. Thanks for the call and thanks for taking my questions. Firstly, on the leverage ratio, do you give a timeframe to meet your 4.5% leverage ratio? And secondly, do you give a bridge in terms of getting from 4% presently to 4.5%? How much do you think you'll do through retained earnings, reducing leverage assets further and any other AT1 issuance? That would be the first question.
- Secondly, I think you're now not intending to issue any capital instruments this year, so on my numbers, you've got a bit of a shortfall in terms of AT1 versus your regulatory minimum on a fully-loaded basis, and also a bit of a shortfall in tier two, if you strip out the trust-preferred securities which probably won't count under the new CRR. So my question is if your CET1 is to fall in the coming quarters, this could start to reduce your headroom for the MDA for your AT1 coupon, so I was just wondering what you think the appropriate management buffer is for the MDA? That would be my second question.
- And finally, on slide 12, I note you're now expecting 4 billion of redemptions in AT1 and tier 2 in 2018 versus 2 billion at the first quarter. Any comments on what the difference would relate to would be good, thank you.
- Dixit Joshi Lee, thank you for joining the call. Your point on the leverage ratio, if we could begin with that. We are, on a phased in basis, at 4.2% versus the fully-loaded leverage ratio of 4% for the second quarter. We have, as you can see in the numbers, done a significant amount of deleveraging in the second quarter, as a result of the repositioning of our CIB businesses, and so I think it does – to the second point – afford us greater flexibility than in the first quarter of last year with regard to capital instruments.
- It is something that we will continue to reassess as we continue to drive further efficiencies in leverage, but it's not something that we're contemplating having to need to address in the near term.
- Lee Street Is there a time frame for hitting 4.5%?
- Dixit Joshi We have previously communicated that this would be a medium-term goal for us. It is something that we have been working towards, as you have seen, through the progress in improvements of our leverage ratio. It is something that we will continue to manage towards and work on both the numerator



and the denominator, so we have flexibility on both fronts in trying to address that in the medium term.

Lee Street

Thank you.

Operator

Next question is from the line of Robert Smalley from UBS. Please, go ahead.

Robert Smalley

Hi, good morning and thanks for doing the call, and thanks for doing the call accessible in US hours as well. Greatly appreciated. Just a couple of quick questions following up on Lee's point. One, I'm sorry I missed it but I know in the past you've put slides on in AT1 payment capacity; you didn't include it this time. Are there any material changes in that, if you were to put that slide in again this time?

Dixit Joshi

Robert, Hi. Thanks for joining. Very happy to do this in US hours, where possible. As you know, the ADI test applicable to AT1s is really an HGB measure, and the HGB accounts are annually produced, so that is something we would typically only produce annually.

As we have reflected, while it's not directly translatable, looking at IFRS and looking at IFRS profitability in the first six months of the year would then translate into a positive improvement for ADI as well.

Robert Smalley

Good, understood, appreciate that. Secondly, I know one of your competitors did an AT1 with a 7.5% coupon; it's now trading about 6.75%. I bring this up because in your slide you're not contemplating that now but it's price-dependent. What kind of area makes sense to you, given the overall funding cost? Is it around where recent levels are for the market? Is it substantially tighter? Could you give us a little bit of guidance there?

Dixit Joshi

I can try and guide you as best as I can, but I would broadly summarize it as we would be economic in our analysis in the first instance and then, of course, take into account all of the other regulatory measures that we would need to meet in making a determination prior to any issuance.

As we mentioned in Q1 and previous quarters, we had a placeholder for capital instrument issuance, but given the deleveraging we have been able to undertake that has gone faster than we had expected in the second quarter in the CIB business As a result of that this will now afford us the ability to make an assessment somewhat later. We already, at the same time, fully cover our 1.5% bucket, so this is something that we will reassess in time.

James von Moltke

Robert, I would add one thing, which is with the EU legislation coming down the pike, from our perspective, it probably makes



- sense to wait until investors have certainty on how ATI will be treated in the future and, potentially, issue with that issue taken off the table.
- Robert Smalley That makes sense, but then, on the flipside of that, now that we've got clarity on the senior non-pref issue, you can go forward with that pretty much when you want to.
- Dixit Joshi The legislation on senior preferred was effective as of 21st July. We very much look forward to getting engaged and opening up that market, and certainly using that instrument as part of our toolkit. It will result in a funding cost reduction and funding cost benefit to us, so it's something that we look to use in the near term.
- Robert Smalley Great and, again, thanks for doing the call, greatly appreciate it.
- James von Moltke Absolutely our pleasure, Robert, thanks.
- Operator Next question is from the line of James Hyde from PGIM. Please, go ahead.
- James Hyde Hello. My question may sound more like an equity question, but now I note that the rating agencies have taken your targets as rating downgrade triggers, in the case of Moody's profit in 2018, IFRS reported profit and, in the case of the other two, effectively your 4% ROE target for 2019, you not meeting them being the downgrade triggers.
- You've given us quite a lot of comfort with these earnings with the cost management side, you are maybe more likely than we thought to meet the 2018 Moody's target, but the next one still seems a bit problematic in terms of revenues, and I wonder if you can give some feel or colour to this?
- So let's take CIB. You have 3.5 billion of underlying revenues or, year to date, last 12 months, 13.5 billion. Now, how much of that is in areas that are basically being cut back to an extent that you would expect them to fall, markets being where they are now? I know it's a difficult question but any colour on that.
- Similarly, the whole weakness in the PCB area, I'm just wondering if the volume offer of the loss of revenues from the business interruption in the Postbank-PGK merger is going to be hundreds? Or what kind of magnitude are we talking about? So it's really now focusing on revenues, these questions. Thanks.
- James von Moltke Sure, James. First of all, I just want to clarify we didn't read the rating agency commentary as saying these are downgrade triggers as much as metrics that they are now monitoring closely in terms of the ongoing performance of the company, and management commitments and our ability to meet our target.



So we understand that the market is looking carefully at our ability to hit those milestones and, as we communicated on Wednesday, we see near-term milestones as a way to rebuild confidence in our forward trajectory, so we are engaged in that discussion with creditors, like yourselves, and rating agencies as well as equity investors, of course.

I would say, secondly, we need to manage this company to returns, and so we've looked carefully at the businesses and the decisions that we made and announced earlier in the second quarter, and focused on areas we felt would be competitive in the long term, in those where we are having a strong franchise and could deliver returns over time.

We have made some adjustments, as we said, in the perimeter, and those adjustments will have an impact on revenues for sure. Our expectation, and this is what we are working towards every day, is that we stabilize the revenues, stabilize the franchise, grow from here.

Of course, there is an effect on the business I'd say particularly in US rates on an ongoing basis, in particular from the leverage that has been removed. And there is some degree of halo effect that goes around the broader franchise, but we are working to offset that, including through, again, greater focus and where we concentrate our resources, and also, in some cases, where we've been able to put through pricing increases to offset the declines.

So hopefully, that helps to answer your question, but we are extremely focused on that effort to stabilize and grow revenues from here towards the targets that we've set for ourselves both in 2018 and going forward.

James Hyde

But would I be realistic in expecting calendar year 2018 to be not 13.5 billion, which is the last 6 months, but something lower? Yes, you're cutting back costs but would it be realistic to look at a lower base for those revenues?

James von Moltke

We have given some guidance in our interim on our expectations and, depending on the business, I think we are realistic that we would be flat to slightly down in a number of the businesses, relative to 2017. Again, that's what we're working towards. We had, I think, a weak revenue performance in the second half of 2017. Remember, when you look at a full-year performance, it includes all four quarters.

We are encouraged, frankly, that we've seen sequential growth in a number of our businesses, and we work to build on that going forward. So again, our outlook is expressed in the interim, and that's what we're working towards every day.



One item that I remembered I did not answer is the PCB revenues. There have been a lot of one-off items in PCB, reflecting perimeter changes and what have you, but what's encouraging to us is that the underlying position has been flat where the business is working hard to offset the impact of interest rate declines, which we sometimes refer to as the deposit margins.

That is something that we intend to continue to build on. And, going forward, we'd expect to overcome those interest rate headwinds, essentially as the rate-related headwinds fall away, and see revenue growth in PCB as well.

James Hyde

And finally, unrelated to that, and maybe for Dixit, this 40 billion stress liquidity, which has gone up from 35-odd, do I take that as a 2008 scenario with multi-notch downgrades, that one? What is that scenario?

Dixit Joshi

The stress liquidity that we have is the internal measure, which goes alongside the external regulatory minimums that we need to meet, including LCR as you know it. We are managing both internal stress measures as well as LCR, by legal entity and at group level, and in some cases by currency as well.

Partly as a result of our deleveraging, we have had excess liquidity that we've created, over time we will be seeking to redeploy the excess liquidity. The models that we run include, across a series of scenarios, a number of outcomes that simulate both market stress, the impact of downgrades, etc. We feel quite comfortable with the modelling and behavioural assumptions that we use.

Versus the risk appetite that the board has set against those measures, we do have room to deploy liquidity, and it's some that we will seek to manage down the best we can over the next few quarters.

James Hyde

Thank you very much.

Operator

Next question is from the line of Jakub Lichwa from RBC. Please, go ahead.

Jakub Lichwa

Hi there, thanks for doing the call. My question, being asked in the context of your lower senior non-preferred funding plan and availability of the new senior preferred debt: how can you justify to your long-term investors, especially the larger holders, the issuance of this new class of debt at a time when some of those investors were sold a note on the basis that these were ranked pari passu with other senior obligations?

I appreciate you may say you're operating within new regulatory guidelines, a new regime, but you could have clearly maintained



the plans for the issuance of senior non-preferred and, say, exchanged some of the existing notes on favorable terms into the preferred senior, which is now available under the new regulation. I appreciate you couldn't have done that before, but now that it's available, that exercise could have taken place. I just wanted to hear your thoughts on that, please. Thank you.

Dixit Joshi

Happy to address that. The legislative change that we've had is the creation of, as you know, an entirely new instrument class which hasn't existed before, and the legislation that was passed at the beginning of last year simply ensured that the debt stack that we had was grandfathered into the new regime, i.e. pari passu with what you had. And so, any issuance that we do in that bucket, as senior non-preferred, will still be pari passu with the existing debt stack that we had.

As I've mentioned, it is very much our intention to issue senior preferred in the near term, so that's very much on the table for us. At the same time we continue to do liability management across our entire debt stack and we will reflect on any options that are available to us as we manage through that. What is good is that we have enough flexibility given both our TLAC, as well as now our MREL surplus that we have, which affords us some of that flexibility in managing both the senior preferred and the senior non-preferred.

Jakub Lichwa

I was just asking a follow-up question, whether the bank is ruling out any exchange or not ruling out any exchange?

Dixit Joshi

As any good treasurer would tell you, we wouldn't rule out any great ideas or economic suggestions, but I wouldn't want to comment on that at this stage.

Jakub Lichwa

Okay, thank you.

Operator

We have a follow-up question from Lee Street from Citigroup.

Lee Street

Hello. I think you only answered my first question on leverage before. I had two other ones, hopefully quite quick. The second one was just headroom to the MDAs. So not asking about ADIs but obviously you're a bit short on AT1 on a fully-loaded basis versus the 1.5% requirement, and also on a tier 2 basis, if you strip out the old legacy tier 1s which are included as tier 2.

So my question is: if your CET1 were to fall a bit further, that would start to reduce the headroom to MDA, so do you have any thoughts or a policy on what the appropriate management buffer is for the MDA in terms of risk-weighted assets purposes? Any thoughts on that would be helpful.

James Rivett

Lee, it's hard to understand you so just let us answer one at a time, I think, because we can't get your questions.



- Lee Street Okay, that was the first question: what's the management buffer for the AT1, please?
- Dixit Joshi Lee, as you'd expect, we do manage to an internal risk appetite and include a management buffer in that regard. On that glide path, we would be looking at legacy instrument run-off. That's one of the reasons why we monitor and publish both our fully-loaded as well as our phase-in numbers. And for most of these measures, we tend to look at the fully-loaded as the measure we manage to, while we publish the phase-in number as well.
- Our 13%+ target for CET1 gives us the buffer that we require over the MDA, but we do look at the MDA as well, on a phase-in basis, and we do look at the tier 1 and tier 2 bucket as well on a phase-in basis.
- James Rivett And what was your next question?
- Lee Street The second one was about your maturities. You've gone up from 2 billion to 4 billion in terms of what you were expecting in 2018. Is that just the... are you looking at the US dollar prefs there or are there any comments on why that's increased from the slide in the first quarter versus the second quarter?
- Dixit Joshi Lee, sorry, the 4 billion was referring to...?
- Lee Street If you go to slide number 11, for 2018 you've got expected contract of maturities of 4 billion for AT1 and tier 2. The same slide at 1Q only had 2 billion, so it was just to try and understand the difference.
- Dixit Joshi The delta was the 1 billion call that we had undertaken of legacy capital which, I think, went through in May.
- Lee Street So that's just one billion, but it's gone from 2 to 4.
- Dixit Joshi It is in the rounding, broadly. But it is the 8% euro 1 billion issue.
- Lee Street All right, thank you.
- James Rivett Thank you, Mia, and thank you, everyone, for joining us. You know where the IR team is if you need us, otherwise we'll speak to you next quarter. Take care.

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