Financial Institutions Ratings
Deutsche Bank AG – AT1 rating report

Securities ratings

Outlook	Negative
6% EUR 1.75bn undated non-cumulative fixed to reset rate Additional Tier 1 notes	B
6.25% USD 1.25bn undated non-cumulative fixed to reset rate Additional Tier 1 notes	B
7.125% GBP 0.65bn undated non-cumulative fixed to reset rate Additional Tier 1 notes	B
7.50% USD 1.5bn undated non-cumulative fixed to reset rate Additional Tier 1 notes	B

The ratings were not solicited by the issuer; the analysis is based solely on public information.

Rating rationale

Scope assigns a rating of B, with Negative Outlook, to the above-referenced, undated non-cumulative fixed to reset rate AT1 notes issued by Deutsche Bank AG. The ratings are based on the following:

- Senior unsecured debt rating (MREL/TLAC eligible): BBB, Negative Outlook
- Minimum notches down from senior unsecured debt rating: 4
- Additional notches: 2

In accordance with our rating methodology, the starting point for notching down when rating capital instruments is the senior unsecured debt rating. The minimum four notches reflect the deeply subordinated status of AT1 capital instruments in the priority of claims, their going-concern loss-absorbing features and investors' exposure to coupon-cancellation risks.

At this time, we see other factors which justify the additional notching beyond the minimum four:

- Deutsche Bank's Available Distributable Items (ADIs) strike us as comparatively low;
- The distance to the combined buffer requirement (CBR) has, for some time, been low compared to our rated peers and the bank's capital accumulation capabilities are somewhat doubtful, especially in light of its earnings performance over the past years. The advantage deriving from the 2017 EUR 8bn capital increase has been partially eroded and, given the group's poor tack record with regard to stable profitability to drive capital accretion, we see the sustainability of a CET1 ratio above 13% at risk.

Please also refer to Scope's *Bank Capital Instruments Rating Methodology* published in May 2018 for more details.

The release of this rating report does not constitute a rating action. The last rating action was assigned on 6 June 2018. For further information on the last rating action and regulatory information please click here

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Issuer credit profile

The Issuer Rating of BBB+ on Deutsche Bank reflects our view that the group's business model and financial recalibration remain less than reassuring, which could affect a return to healthier profitability and more sustainable growth in business volumes.

Deutsche Bank's Strategy 2020 agenda, which is ongoing since 2015, was updated in March 2017 and should gradually address many of the intrinsic weaknesses in Deutsche Bank's business model and fundamentals. Nevertheless, the process of business-model streamlining, cost-cutting, further deleveraging and capacity reduction has already taken a toll on medium-term profitability and is likely to continue to do so.

Summary terms

Issuer	Deutsche Bank
Issue date	**May 2014**
Amount	EUR 1.75bn
Coupon	• 6% fixed until first call date, reset every five years thereafter • After first call date, rate equal to 5Y EUR swap rate plus 4.698% • Payable annually
Format	Undated non-cumulative additional Tier 1 notes, callable on 30 April 2022 and every five years thereafter
ISIN	DE000DB7XHP3

Issue date	May 2014
Amount	USD 1.25bn
Coupon	• 6.25% fixed until first call date, reset every five years thereafter • After first call date, rate equal to 5Y USD swap rate plus 4.358% • Payable annually
Format	Undated non-cumulative additional Tier 1 notes, callable on 30 April 2020 and every five years thereafter
ISIN	XS1071551474

Issue date	May 2014
Amount	GBP 0.65bn
Coupon	• 7.125% fixed until first call date, reset every five years thereafter • After first call date, rate equal to 5Y GBP swap rate plus 4.257% • Payable annually
Format	Undated non-cumulative additional Tier 1 notes, callable on 30 April 2026 and every five years thereafter
ISIN	XS1071551391

Issue date	November 2014
Amount	USD 1.5bn
Coupon	• 7.50% fixed until first call date, reset every five years thereafter • After first call date, rate equal to 5Y USD swap rate plus 5.003% • Payable annually
Format	Undated non-cumulative additional Tier 1 notes, callable on 30 April 2025 and every five years thereafter
ISIN	US251525AN16

Main risks	
Coupon Cancellation	• Fully discretionary • Mandatory if coupon payments on all own funds instruments a) would exceed the Distributable Items of the issuer; or b) would cause the Maximum Distributable Amount (MDA) then applicable to the issuer to be exceeded. Cancellation is also subject to the competent supervisory authority's decision, or another prohibition of distribution is imposed by law or an authority.
Principal loss absorption	• If the group's CET1 ratio falls below the trigger level, the issuer must reduce the current principal amount of each note by the relevant write-down amount, in a sufficient proportion to bring the CET1 ratio above the trigger • If an annual profit is recorded at any time then the issuer may, at its full discretion and subject to the MDA, increase the current principal amount of each note up to a maximum of the original principal amount on a pro-rata basis with the other notes, provided such a write-up would not increase the annual loss. • Resolution authorities may reduce the principal amount of the notes to zero on a permanent basis or convert the notes into CET1 capital at the point of non-viability (PONV) or in any case in the context of regulatory bail-in.
Trigger for principal loss absorption	Consolidated group CET1 < 5.125% on a transitional basis

Source: Prospectuses, Scope Ratings

Key risks

A. Coupon cancellation

Key risk: coupon cancellation

Coupon payments are fully discretionary and are subject to distribution restrictions.

Coupon payments on the securities are fully discretionary and are subject to distribution restrictions. Moreover, coupons are mandatorily cancelled if there are insufficient distributable items (based on issuer accounts on an unconsolidated basis) or if payments exceed the MDA. The MDA is calculated if the issuer does not meet its Combined Buffer Requirement (CBR).

Available Distributable Items

The ability for Deutsche to pay coupons on its AT1 notes will depend on its ability to generate enough Available Distributable Items (ADIs) at the parent company level. Deutsche's ADIs are calculated as:

The distributable profit at the parent level, which under German GAAP accounting principles includes both the year's net income and the profit carried forward, plus revenue reserves. Part of this amount is, however, blocked, as non-distributable reserves (e.g. share premium account, internally generated intangible assets and deferred tax liabilities) must be deducted. The resulting ADIs are then added to the prior year's interest expenses on CRR-compliant and legacy Additional Tier 1 instruments.

Table 1: Available Distributable Items Deutsche Bank AG parent company 2014-2017, EUR m

	YE2014	YE2015	YE2016	YE2017
Distributable Profit	1,169	165	447	399
Other revenue reserves after net income attribution	6,332	6,323	6,280	6,560
Net distributable profit / Total dividend potential	7,501	6,488	6,727	6,959
Minus non-distributable reserves (dividend amount blocked § 268 Abs. 8 HGB)	5,483	6,254	6,213	6,562
= ADIs	2,018	234	514	397
+ Increase for interest expenses on T1 instruments	852	858	724	694
Total amount available for interest payments on T1 instruments (ADIs)	2,870	1,092	1,238	1,091

Source: Company data, Scope Ratings

We estimate that Deutsche Bank paid ca. EUR 320mn in coupons on new AT1s on 30 April 2018, while we estimate the coupons paid (and to be paid) on legacy instruments during 2018 to be ca. EUR 170m, taking into consideration the call of two instruments in January and May 2018. Despite being sufficient, compared to other issuers, Deutsche Bank ADIs strike us as comparatively low.

Combined Buffer Requirement (CBR)

Article 141 of CRD IV imposes certain restrictions on discretionary distributions (dividends, variable remuneration and payments on AT1 securities) if the CBR is not met. The CBR comprises the capital conservation buffer, the countercyclical buffer and systemic risk buffers as applicable. The MDA needs to be calculated, if banks supervised by the ECB do not meet both Pillar 1 and Pillar 2 capital requirements as well as the CBR.

By 2019, we estimate that Deutsche Bank will need to maintain a CET1 ratio of at least 11.8%, a Tier 1 capital ratio of 13.3%, and a total capital ratio of 15.3% to avoid distribution restrictions (Table 1). This assumes that the Pillar 2 requirement of 2.75% does not change, the capital conservation buffer is fully phased-in to 2.5% and the countercyclical buffer remains around 0.02%.

Deutsche Bank is currently subject to a 2% G-SII buffer requirement in 2019 and an O-SII buffer of 2% to be met in 2019 as well, but with different phase-in steps. According to Article 131.14 of CRD IV, the higher of the two applies, which in 2018 is the G-SII at 1.50%.

The group's capital position benefited from the EUR 8bn capital increase completed in April 2017 and recorded in Q3 2017, which added 200 bps to the CET1 ratio (both under transitional rules and fully-loaded)[1].

Q1 2018 CET1 ratio stood at 13.4%, 270 bps above the requirement (including the CBR), reflecting some one-off effects as IFRS9 day-one in negative and DWS minority sale in positive. Management targets a ratio "comfortably" above 13%.

[1] As of 1 January 2018, with the phasing-in of 100% transitional adjustments and the exclusion of minority interest, CET1 under transitional rules and on a fully-loaded basis converged. Also, transitional rules for the recognition of equity investments in risk-weighted assets expired.

Table 2: Distance to estimated capital requirements

	2017	Q1 2018	2019
Required CET1 associated with distribution restrictions	**9.5%**	**10.6%**	**11.8%**
Combined buffer (CBR)			
- Capital conservation	1.25%	1.88%	2.50%
- Systemic (G-SII)	1.00%	1.50%	2.00%
- Countercyclical	0.02%	0.02%	0.02%
Pillar 2 CET1 requirement	2.75%	2.75%	2.75%
Pillar 1 CET1 requirement	4.50%	4.50%	4.50%
Deutsche Bank AG CET1, transitional (%)	14.8%	13.4%	Target >13%
Distance to CET1 requirement incl. CBR (%)	**5.3%**	**2.7%**	
Distance to CET1 requirement incl. CBR (EUR bn)	**18.1**	**9.6**	
Deutsche Bank AG Tier 1, transitional (%)	16.8%	15.8%	
Required Tier 1 incl. CBR (%)	11.0%	12.1%	13.3%
Distance to Tier 1 requirement incl. CBR (%)	**5.8%**	**3.6%**	
Deutsche Bank AG total capital, transitional (%)	18.6%	17.5%	
Required total capital, incl. CBR (%)	13.0%	14.1%	15.3%
Distance to total capital requirement incl. CBR (%)	**5.6%**	**3.4%**	
RWAs (EUR bn)	343	354	

Source: Company data, Scope Ratings

B. Principal loss absorption

Key risk: principal loss absorption

The mechanism for loss absorption is temporary write-down.

The securities have one trigger:

- 5.125% CET1 ratio, transitional basis

At its discretion, the group may write up the principal amount of the notes if it reports a profit, subject to the constraint of the MDA.

Distance to trigger

As of 31 March 2018, Deutsche Bank's CET1 ratio was 13.4%, well above the trigger of 5.125% (Table 2). Considering the group's minimum CET1 requirements (SREP plus G-SIB buffer) and management's 13% plus CET1 target, we expect the group to remain solidly positioned with regard to the trigger level.

Table 3: Distance to trigger

	2017	Q1 2018	2019
Trigger level	5.125%	5.125%	5.125%
Deutsche Bank AG CET1, transitional (%)	14.8%	13.4%	Target >13%
Distance to trigger (%)	**9.7%**	**8.2%**	
Distance to trigger (EUR bn)	**33.2**	**29.2**	

Based on EUR 343bn in risk-weighted assets as of YE2017 and EUR 354bn in risk-weighted assets at Q1 2018

Source: Company data, Scope Ratings

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