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Transcript

Speakers:
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Daniele Brupbacher, UBS

Daniele Brupbacher: (UBS)

Good morning and welcome to the UBS European Conference 2021. My name is Daniele Brupbacher. I've been a bank analyst with UBS for almost 19 years. I would like to introduce you to our next speaker today, James von Moltke. James joined Deutsche Bank as CFO, a bit more than four years ago, summer 2017. So, James, welcome. Thank you for being here in-person, which is great.

James von Moltke:

Daniele, delighted to be here. Thank you for hosting me today.

Daniele Brupbacher:

Thank you. So, you presented at our European Conference three years ago in 2018, and I remember our fireside chat, the discussions we had, we had many more people in the room, but fewer online – now it's the other way around. A lot of things have changed also for Deutsche Bank. Back then we talked about market share losses. We talked about vicious debt/equity circle, litigation, capital, noncore. This year we talk about Deutsche Bank regaining market share. We talk about the strong balance sheet. We talk about rating upgrades. We talk about real alpha and cost and revenue management and capital returns eventually. So my questions will be along these lines and I wanted to kick off briefly on the third quarter results. Just to hear you talk a little bit about the key messages, key achievements you've had so far this year.

James von Moltke:

Sure. Thank you, Daniele, and delighted to be with you as I say. It's been a journey since three years ago, when we last had a chat like this and it's been one of executing on the strategic repositioning of the company that we announced in July 2019. So a little bit after that conversation, but one that's been, I think, executed well over the last several years. And as you say, it has put us in a very different position today than we were at the time. In terms of where the businesses are and the momentum, it's been quite gratifying to see a more stable platform with a level of client re-engagement that I think is continuing to improve, our businesses are performing well. They're performing with driver growth, which I think is critical.

So drivers here are net new loans, net new assets, and just business volume growth that's present in the businesses. That's been helped, as you say. And there is a virtuous circle that we've been working to create over the years from ratings upgrades. We had the third of three in the last several months yesterday from S&P that's certainly part of the story that's helping to lift the businesses, and also will in the future. The other feature that we've had over the past several years, that's been a headwind we've talked a lot about, has been interest rates. And that interest rate environment is beginning to ameliorate, not just in the forward curves that have improved a little bit.

Also, remember we invest our deposits against a duration of the deposits. And so, when we talk about interest rate headwinds, it's the reinvestment of our deposits at higher rates in the past that have run off now, those investments, we can now reinvest at slightly higher rates than in the recent past. And so, it goes from being a burden on our revenues on a year and year basis, to being a help in the revenues. So, we're seeing that development on all the businesses and quite encouraged by the drivers.

Daniele Brupbacher: Great. Thank you. We'll talk about some of these topics you'll mention in a bit in more detail later. Let's start with the top line. Let's start with the revenue walk, Christian Sewing talked about it at the Q3 results. It's really about the divisional 2022 revenue targets, I'd be interested to hear your thoughts around that, what the drivers are in that context for the businesses. Again, a bit more detail, particularly for Private Bank and the Corporate Bank. And also you mentioned it already, the interest rates, how important is that specifically in these two divisions – that would be useful?

James von Moltke: Happy to go through that. Look, we called for a revenue base next year. So next year is an important year for us around achievement of targets that we laid out back in 2019, which were an 8% ROTE and a 70% cost to income ratio. The revenues that feed into those targets, we called for last December at a capital markets day, of 24.4 billion. And what Christian was talking to was management's confidence at this point, that revenues next year will be at or likely higher than 25 billion. And so what is it that's going to drive that revenue growth? Well, if I start with Asset Management, which is maybe the easiest of the four businesses to explain, the higher level of assets under management is driving a higher current run rate of revenues in the business for management fees than we thought was possible a year ago.

And so that run rate is 200 or 300 million euros per year ahead of our planning in December of last year. The Investment Bank of course has outperformed in very strong markets over the past 18 months. And while we're encouraged by that performance, we think there's an underlying market share improvement and resilience that the investment bank is showing. Of course, there's some degree of normalization against the very high levels of revenue that we've achieved in the past 12 months. Again, we think that's got some underlying strength to it, but there'll be a reduction next year, relative to the current run rate. And then as you point out the Corporate Bank and the Private Bank are the areas where investors are waiting to see sustainable revenue growth, sustainable profit growth to come through. And the reason that's been a long time coming and not that visible on the top line is the very point I made a moment ago about interest rates.

If you look at 2021 and compare to 2022, just to keep revenues flat, we've had to increase the underlying revenue performance by 700 million. So, that interest rate headwind we talk about is about 700 million year on year, this year. Next year we had anticipated that it would fall by about half, based on interest rate curves that we cut say a year ago. Now that half has diminished to as little as a quarter or less. So maybe 150 million of interest rate headwind next year, compared to 700 million this year. So that means that the underlying growth in those two businesses that we see there based on the drivers, based on loans, based on assets under management, based on higher transaction volumes in the businesses, that growth can now show through and will start to show through as it did in the third quarter, but increasingly in the quarters to come. And so that's a big driver, as I say, of what'll be the top line, the visible top line performance now reflecting the underlying performance that we've seen for the past couple of years.

Daniele Brupbacher: That sounds very positive. If we now try to make the link to the cost line, in that sense, I think it was with Q2 results, you shifted a bit away from an absolute cost target, more into a cost/income ratio ambition, if you could briefly talk about that move. And also what drove that, I think you mentioned volume effect and some of the one-offs, if you could just detail that a little bit.

James von Moltke: Sure. Happy to. Look, we thought long and hard about it for the past several years. So 2018, 2019 and 2020, we managed to achieve absolute cost targets. And actually we laid out a plan number even for 2021 in absolute terms. But as our transformation has progressed, the concern is you're starting to make poor decisions for the businesses if you're managing to absolute cost targets, because a lot of the investments that you make should be based on the marginal benefit to the cost/income ratio, to the operating leverage, which those investments can produce. And so we thought it had come time to change that targeting language. Now at the time we made that switch, it was not really a change in the underlying cost base that we'd been talking about.

25 billion of revenues with costs at a 70% ratio would imply all in about 17 and a half billion of cost next year, that was consistent with what we'd already begun to signal earlier this year, reflecting some costs that you're referring to, that we've characterized as uncontrollable, and they are uncontrollable, the specific items that we saw coming in that we indicated we would not offset with investment reductions or other offsets relate to the single resolution fund. The European banks are still paying into a resolution fund at higher levels than was originally anticipated.

So while we'd made assumptions of a declining assessment, the reality is that assessment has remained at high level. And in fact is increasing. We decided that it wasn't controllable. We need to make long term franchise decisions rather than near term decisions to offset that pressure. There was a second one, together they amounted to about 400 million euros relative to our planning. The second item was deposited insurance, where the assessments, again, increased in Germany, reflecting a bankruptcy that took place.

Daniele Brupbacher: Yes. If we can stay with cost for a minute, I think it was also in September when you announced additional transformation charges, the ones you just mentioned, and just how should we think about the future cost run rate also then beyond 2022 to what more additional benefits are probably going to show up from costs going away or some other benefits coming through, and probably in this context as well, cost flexibility is an important discussion we are having with investors also for what happens if revenues go down, how do you think about cost flexibility in general for the group or?

James von Moltke: Well, there's a lot to talk about obviously. And so, the general statement is we are working hard on our costs. We're trying to execute measures that bring down our sustainable cost base. And by the way, as you alluded to, we announced a higher level of transformation related effects in September. And we're working to book as much of that as possible this year. We're working hard to clear the decks in 2021 of transformation charges, and also other costs ahead of what is a measurement year. Next year, we've got targets to meet, and we're very focused on doing that. But as I mentioned, there were some items that were uncontrollable in our cost base coming through. There's also inflationary impacts that are coming through, some of which have to do with better performance on the revenue line.

So variable compensation is an example there, asset servicing costs in the asset management businesses. And what we're trying to do is offset those and also additional control investments that we need to make. Those things are pushing up our expense base. And what we're trying to do is come up with new measures that we implement that can then offset those. That's a battle, but we took some decisive action, particularly around our technology estate over the course of this year, which resulted in some charges in the third quarter that were taken to try to offset those pressures. Longer term, Daniele, as you say, we do think there's some structural benefits that we're building into the run rate after 2022. So, very often, and I've been nervous about this as a CFO, a cost reduction plan would give investors the impression that we're squeezing the company to the point where investments in the franchise for the future aren't being made which then leaves you at a competitive disadvantage at some point.

We're trying to avoid that. We're trying to balance the cost savings and the investments in a way that are franchise enhancing over time. And those franchise enhancements can be on the revenue side. So, client facing technologies and also people that drive revenue in the future, but they can also drive benefits in the cost base. And I think there's a lot built in at the moment to the run rate that will fall away over time. A great advantage example is we're making a significant investment in the technology that supports our retail business in Germany, merging two banks, Postbank and the Deutsche Bank branded business. That's an enormous investment this year and next year, but that investment will result in significant cost benefits in 2023, as not just the investment cost rolls off, but also the duplicative platform. And we should also be driving some, I think, revenue upside from better client facing capabilities that we've invested in.

Daniele Brupbacher: Okay. Interesting. Switching gears to the recent rating upgrades, and I think it's quite topical as S&P upgraded Deutsche yesterday. And we had Moody's and Fitch before in the third quarter I think, can you talk about that? Can you talk about what it really means for the business? I mean, I remember you lost business because of the downgrade a few years back, what does it mean now? Can you quantify that? Do you have a feeling for what it means in the various businesses and people, it would be super helpful.

James von Moltke: Yes, now briefly, yesterday's upgrade from S&P was one that we've been waiting for some time, very important to us from a business perspective, because being A-rated in the senior preferred or the counterparty credit rating for a bank like ours is important. There are counterparties that simply can't do business with you or on an uncleared basis, unless you have those ratings, they will come back. As you say, when we lost that rating, the impact on revenues to us was in the triple digit millions of lost revenues.

And so we expect that to come back. Some of it actually has probably been bleeding into the revenue for some time as people do their own credit work on Deutsche Bank. But some of it will come back now, switching on, and it's counterparties in the FIC business, it's corporate treasurers in our Corporate Bank that can do more cash management with us. And to some degree there's a Wealth Management client segment that can be rating sensitive as well. So, we'd think in all of those three areas, there are benefits that will accrue in the near term to us.

Daniele Brupbacher: Great. And we talked about revenue costs, let's go through the P&L, risk costs. And I think you started the year saying it should be below 2020. In 2020, I think it was 40 basis points, and then it was 25, and then it was 15, and now it's below 15. And that's driven by external and internal things. If you could, just talk about your expectation of the remaining quarter, because it still implies a relatively high level in the fourth quarter. And then probably going into 2022, is that back to normal? What is normal? How do you see that trajectory going?

James von Moltke: Yes, look, the credit environment remains very benign, so we've seen this very unusual credit cycle with the pandemic. I won't go into that and what it's meant, but this year credit conditions have been very good. You've also had some releases of management overlays, forward looking IFRS 9 provisions and also recoveries. So, it's been very benign, as you say, running it, I think 10 basis points in the third quarter, seven or eight basis points for the year to date; we've called for a little bit less than 15 basis points for the year. And as you rightly point out, it means that credit loss provisions would probably be 250-ish million in the fourth quarter, having run at 250 million for the first nine months of the year. And that's just a function of no longer repeating the release of those management overlays, forward looking reserves under IFRS 9 and some of the recoveries, and is a path towards normalization. Next year, Daniele, I would still expect the credit provisions to run below a normalized level.

So if we would call for normalized credit provisions in and around 25 basis points, if you just split the difference between 15 and 25, somewhere in the middle, you'd probably be at our best guess for next year, again, looking at the environment and what we can see today.

Daniele Brupbacher: Do you have any specific pressure points from a regional point of view, or is it government support? When you look at the book, where do you have the biggest uncertainties, or is it China? Is it supply chain?

James von Moltke: Well, earlier in the year, we were looking carefully at aviation and commercial real estate. These are two pockets that we were worried would begin to see stresses in the back half of the year; that hasn't panned out at all. In fact, both, particularly aviation at this point are showing strength and the commercial real estate downside really hasn't materialized, that we were looking as a possibility. And by the way, it was that possibility that fed the higher guidance that we had, and we've walked it down during the year. As we finish 2021, there's more concern in areas like

China and China real estate, and whether there are stresses that might emerge there.

I think it's too early to tell for sure, but we are not seeing stresses in the banking book in China, even in real estate. Now that's maybe our book. We have a relatively manageable, well underwritten credit book in China, generally, also in real estate in China, very strong sponsors, good loan to value levels. So, it's somewhere we're watching carefully, but it's not an expectation we have that there'll be significant CLPs around that.

Daniele Brupbacher: And if we stay briefly with the credit topic on just loan book, growth has been good in certain areas. There is a discussion around corporate loan growth demand in Europe. What have you seen there from a company specific point of view?

James von Moltke: Yes, we're more optimistic, Daniele. I know there was some differentiation among the banks in the third quarter, in terms of where they were going in loan growth. We had about 11 billion in total of loan growth across the franchise, just in the third quarter, which was encouraging. There's a steady loan growth pattern that we see in the Private Bank weighted towards mortgages. In the Investment Bank we still believe there's the ability to put lending to work financing clients at good spreads and within our risk appetite that may not persist for that much longer. But certainly, we think we see those opportunities today.

And then the Corporate Bank, as you rightly ask about, we did see good growth in the third quarter, in our trade finance book, it was about three billion just in the quarter in trade finance, having been flatter, even down, since the pandemic-induced bubble. I think it's too early to say that's a trend, I call that green shoots for now, but we do see the possibility just looking at client activity and what's going on in the supply chain world. And in that, there's legs to a trade finance growth story.

Daniele Brupbacher: Okay. Thank you. Let's talk about capital returns, and you did make some quite specific statements already last year at the Investor Deep Dive, the IDD, and I think you put out the five billion number, there wasn't really a time horizon attached to it – if you could just elaborate around your recent thinking, dividend buybacks, when, what is the process you're going through? What's the outlook?

James von Moltke: Look, it's very important to us, Daniele. When we announced our restructuring or transformation in July of 2019, we laid out one of our objectives was managing capital carefully through this transformation period, dealing with the impact of reg inflation. And we've nearly finished that period of time. So, if we finished 2021 at the CET 1 ratio that we've called for, which is around 13%, we will really have finished that period of pressure on the ratio, absorbed about 150 basis points of regulatory inflation, maybe 80 basis points of capital relevant transformation charges. And we'd been able to fund all of that with organic capital generation in our Core Bank and the de-leveraging that we did in the Capital Release Unit, as well as some benefits on operational risk out of your way. So, we're really pleased with that picture.

It positions us now to begin that capital return of five billion with, I think, a significant sort of, I call it first installment next year. So, to be decided in time, including at the AGM, we're not far enough into that work Daniele at this point to really be able to talk about the size and the mix of that capital return. My hope is that we'll advance that discussion both internally and in terms of our capital planning with our supervisory board and as appropriate with the regulators. So that when we tell the market what that'll look like, we'll have a very clear path and plan, but as I see it here today, I'm optimistic that we're well on track. And of course, we're always, as you say, vague about the end point, but in fairness, if our planning horizon was five years, then that horizon is shortening, as time goes by, and we feel quite confident.

Daniele Brupbacher: And generically, dividend versus share, how do you look at that discussion, also bearing in mind things like share price levels, valuation levels of advantages and disadvantages.

James von Moltke: Look, generically, I think there should be a mix. I think management should be able to set a dividend rate and a dividend policy that signals its views about the future, its views about growth opportunities and the sustainable path going forward. But we're not blind to the corporate finance math that share repurchases, especially valued where we are today, are quite powerful in terms of the leverage they provide to earnings per share and book value per share. So, I think it needs to be a mix. What that mix is, is really too early to say.

Daniele Brupbacher: Okay. And again, on that topic, the 8% RoTE obviously is an important target for you. I think the market is a little bit more skeptical for the known reasons, I guess, but how important is the 8% for the five billion and is there a buffer built in?

James von Moltke: Well, again, the first installment will be essentially based on where we finish this year. First of all, the 8% is absolutely what we've been working towards, building the foundations, kind of the building blocks and executing towards. But I think in a way you've got to separate the transformation aspect of where Deutsche Bank will be next year from the 8%. The transformation sets us up, not just to achieve the 8% next year, but for ongoing performance in the years beyond. And with this changed capital regime that we'll be in, from capital preservation to organic capital generation reinvestment of that capital in the businesses and the distributions. I feel very comfortable about that path, and at the margin, will be influenced by the RoTE, of course, but at the margin, I feel comfortable with it. Even if there's a slight miss to the 8%.

Daniele Brupbacher: And if we stay briefly with the topic, you mentioned 150 basis points, there has been reg inflation, RWA inflation, what else is to come if you could just share that with us? Over which time horizons and how relevant it is?

James von Moltke: Yes. Well, look, one uncertainty apart from just getting this wave of regulatory inflation behind us, so TRIM, and the other changes, the rule changes have taken place. There was uncertainty until we had letters and had finished the work. So that uncertainty is now behind us. The next uncertainty was the Basel III final framework. Now that we have a legislative proposal, we can see what that proposal at least would indicate for us. So, more visibility in the future. There are a lot of things in that proposal that we welcome. So, I think, good proposals that lessen the burden, the impact on the European banks. For us, it's still a relatively sizable impact. If you take the optimistic end of the assumptions that we had laid out, those assumptions were for a 25 billion increase in risk weighted assets, initially in 2024, associated principally with FRTB, the fundamental review of the trading book. That's moved out to 2025, which is helpful.

James von Moltke: And then the next wave, which is the output floor related capital increases, that's actually now pushed out to 2029 and 2030, and it has some, at least temporary improvements in it. So that improves, I think, the output floor impact ceteris paribus. So if nothing else changes about the composition of our business, how we conducted it and so on, it would result in another, say, 35 billion, if fully reflected in 2030, but there's a lot that can change over the next eight or nine years. So, we feel that the Basel III framework now is giving us more certainty of the capital path, and to your question, underscores if you like a greater degree of confidence we have in what we can deliver to shareholders going forward, meeting our promises.

Daniele Brupbacher: So I have probably two questions left. One, is more around, you announced the restructuring, the new strategy, new divisions, let's say two and a half years ago. So we are probably a bit like midterm halfway through. How do you perceive the mood internally? I mean, I see ratios like commitments, staff turnover, all going into the right direction. How do you see these topics on the talent side retention, being able to hire the right people, employee mood ability to compensate them?

James von Moltke: Yes, it's very powerful Daniele, you know what? I started talking in June of 2018 about a virtuous circle that came with better performance, a better platform, employee engagement and retention, which translates into customer engagement and further into new revenue opportunities for the company or revenue growth fed by ratings improvements. And I think all of those things are happening – as you see, the internal measures that we have of things like employee engagement have been very encouraging. They clearly support the strategic direction, their support of the execution that I think we've delivered. And it is translating into the customer engagement and improvements that we'd hope for. So, the short answer, Daniele, is the platform feels transformed today in terms of what we can do. And also, by the way, our ability to retain and attract talent to Deutsche Bank.

Daniele Brupbacher: Great. Let's probably finish off with the upcoming investor day, it's on March 10th, I believe next year, you announced it. What are you going to talk about? I mean, you obviously can't disclose too much, but what do you think is going to be important to the market, to our sell-side analysts? The topics you will focus on?

James von Moltke: Sure, that's a very fair question. And a lot of work to do from now till March 10th, but we look forward to that engagement with our investors. So I think first of all, we have to cover what's been achieved with a transformation with a bit of a retrospective, but not spend too much time on that. Talk about the targets in 2022 and how we're positioned against those targets but spend most of our time talking about how the transformation of Deutsche Bank is going to deliver benefits in the future, in this period of time, let's say 2023 to 2025. How is it that we've repositioned the company for performance and financial as well as strategic delivery?

And what do we think about is that repositioning, I think we've got to tell a story. In other words, that goes beyond the recovery of Deutsche Bank into 2022, and the achievement of the targets, those targets can't be the endpoint for the company. They have to be a staging ground to something beyond. And so, really we're focused on telling that story and a lot of work to do to underpin it.

Daniele Brupbacher: Great. Thank you. Thanks for this sneak preview. I think we have to stop here unfortunately. I would like to thank you for being here in-person. Congratulations, what you've have achieved with the company, with your employees, with the whole firm. Thanks for being here in-person. I enjoy this a lot, and I hope to welcome you again next year.

James von Moltke: Thank you, Daniele. No, as you said, we're a little bit better than halfway through, but compared to when we last sat on a stage together three years ago, a lot of distance travelled, but we're equally humble about the work that still lies ahead, not just in the next five quarters, but in the years to come thereafter. So, thank you for hosting me today.

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This transcript also contains non-IFRS financial measures. For a reconciliation to directly comparable figures reported under IFRS, to the extent such reconciliation is not provided in this transcript, refer to the Q3 2021 Financial Data Supplement, which is available at www.db.com/ir.

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