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Deutsche Bank AG

Deutsche Bank's €1.3 billion provision for Postbank litigation will reduce Q2 profit

On 26 April, Deutsche Bank (DB, A1/A1 stable, baa2[1] announced that it will book a €1.3 billion provision for all claims related to its 2010 Postbank acquisition, including cumulative interest, in the second quarter of this year. The provision follows the Higher Regional Court of Cologne's preliminary assessment of select former Postbank shareholder claims that DB paid too little for Postbank and breached German law on takeovers. DB disagreed with the court's preliminary assessment, but is making the provision, which is equivalent to all Q1 2024 net income attributable to DB shareholders.

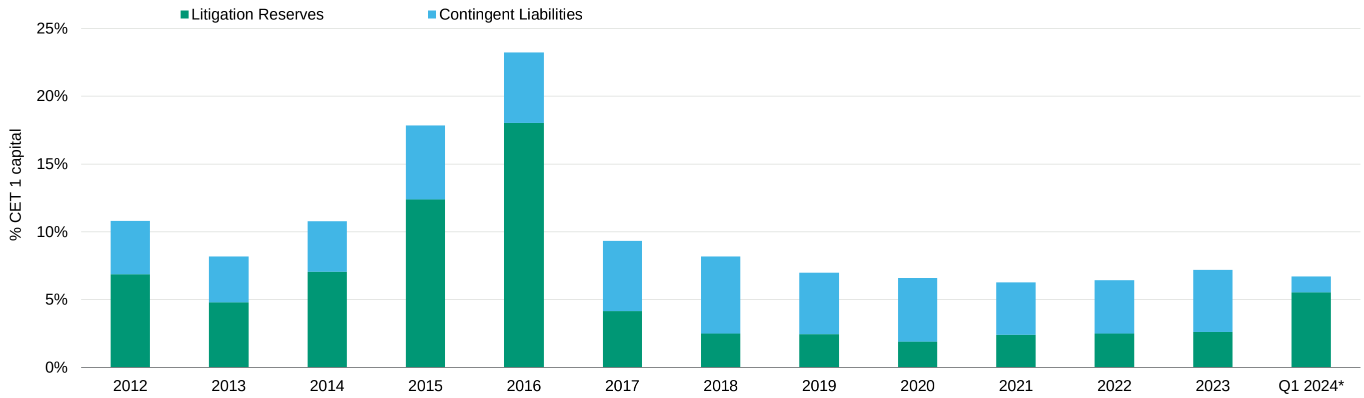
The provision will reduce DB's Common Equity Tier 1 ratio by approximately 20 basis points to around 13.25% from 13.45% as of 31 March, a credit negative impact for the bank even though it did not change its guidance on capital targets for 2024 and 2025.[2]

In several prior lawsuits on this matter, a number of courts ruled in DB's favor. However, the Cologne court's preliminary assessment supported some elements of the claims, which prompted the bank to provision for a probable loss event. DB previously assumed a low likelihood of liability and incorporated the €1.3 billion risk as part of its reported €1.9 billion "contingent liabilities" as of Q1. Since the provision charge covers the total value of all claims and cumulative interest, contingent liabilities for possible future litigations drop to €560 million. The court indicated it would announce a decision on 21 August, but the bank has the option to settle with the plaintiffs before.

Although the court's final judgement and the lawsuit's final cost are pending, the €1.3 billion provision charge in Q2 equates to around 18% of full-year 2023 pretax earnings. DB's integration of Postbank has been a challenging and costly process. Significant operational difficulties during the IT migration to one platform in 2023 resulted in customer complaints to Germany's financial watchdog BaFin and an IT remediation program at the bank.

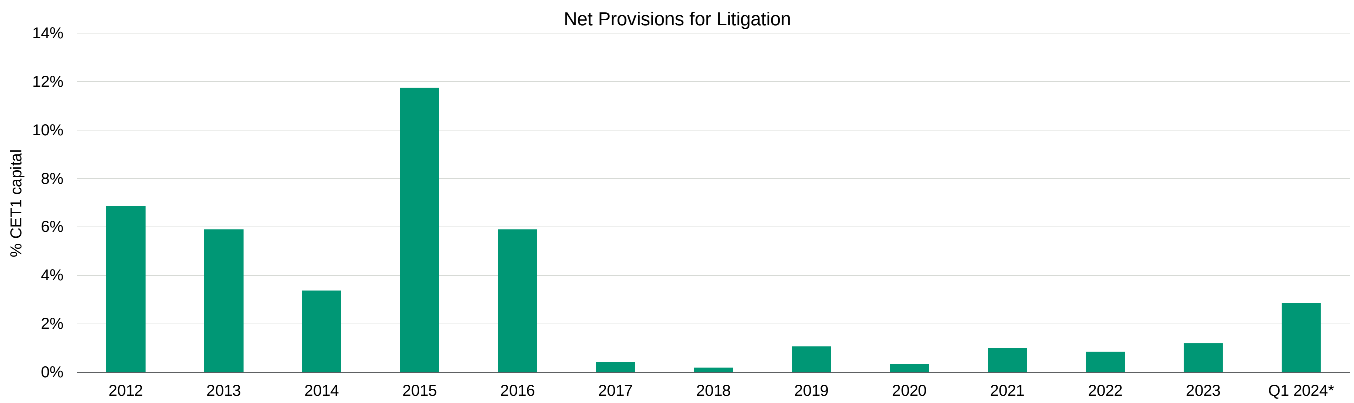
In the past decade, DB settled many legacy litigations and completed a material strategic revamp in 2022. Consequently, litigation, regulatory and restructuring costs significantly declined, which helped the bank regain operating leverage for 18 consecutive quarters since Q4 2019. Litigation provisions peaked in 2015 and 2016 at around €7.7 billion net of releases. Since then, DB has booked yearly average provisions of €0.3 billion and used €8.3 billion of its reserves as of year-end 2023 (Exhibit 1), reducing its litigation reserves and contingent liabilities by 35% to €3.5 billion, or 7% of its CET1 capital (from €9.8 billion and 23% of CET1 capital in 2016). With the €1.3 billion provision charge in Q2, we expect litigation provisions in 2023 to be the highest since 2016 (see Exhibit 2).

Exhibit 1
DB has used €8.3 billion of its provisions for litigation since 2016



Contingent liabilities include potential obligations where an estimate can be made and an outflow is more than remote, but less than probable.
Sources: Company reports and Moody's Ratings

Exhibit 2
DB's provision charge in Q2 2024 will likely be the highest since peak provision charges in 2016



*Q1 2024 is not annualised and includes the €1.3 billion provision charge for Q2
Sources: Company reports and Moody's Ratings

If DB's material provision charge significantly affects its Q2 results, we do not expect it to derail the year-end 2025 financial targets, which include a 62.5% cost-income ratio, a 5.5%-6.5% compound annual revenue growth rate between 2021 and 2025 and a return on tangible equity higher than 10%. In Q1, DB reported a pretax profit of €2 billion, up 10% from Q1 2023, reflecting steady performance and lower operating costs that more than offset exceptional litigation costs and higher loan loss charges. However, the Q2 charge may alter the shareholder distribution trajectory, which DB committed to increase above the initial €8 billion plan for 2021-25 and commenced with a €675 million share buyback program that it expects to complete in Q2.

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Endnotes

1 The bank ratings shown in this report are the bank's deposit ratings, senior unsecured debt rating and Baseline Credit Assessment.)

2 Because DB's CET1 ratio as of end-March 2024 deducted 50% of the payout of the €1.3 billion net income attributable to DB shareholders, the €1.3 billion provision charge effectively brings the pro forma Q1 net income to 0 and the CET1 capital effect is around €650 million.

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