



Deutsche Bank AG

Deutsche Bank Q3 2019 Fixed Income Conference Call

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Transcript

Speaker Key:

James von Moltke, Chief Financial Officer
Dixit Joshi, Group Treasurer
Philip Teuchner, Investor Relations



Philip Teuchner

Thank you Stewart, and good afternoon or good morning and thank you all for joining us today. On the call, as always, our CFO, James von Moltke, will speak first. Then our group treasurer, Dixit Joshi, will take you through some fixed income specific topics. In the room for Q & A, we also have Jonathan Blake, our Global Head of Issuance and Securitisation. The slides to accompany the topics are available for download from our website under db.com.

After the presentations, we'll be happy to take your questions. But before we get started, I just have to remind you that the presentation may contain forward looking statements which may not develop as we currently expect. Therefore, please take note of the precautionary warning at the end of our materials. With that, let me hand over to James.

Slide 3 – Tangible progress on our strategic transformation

James von Moltke

Thank you Philip, and welcome from me. I'll talk you through our third quarter results but also provide you an update on how we have progressed in executing our strategy.

This management team is absolutely focused on execution, as we show on slide three. We feel comfortable that we have laid the foundations for a successful restructuring and improved business performance. We're delivering on our near-term objectives which sets us up to deliver on our long-term goals.

Overall, we can tell you we are on track. The trends in the core bank, the performance in the capital release unit, headcount, costs and capital are all running in line with or better than we had planned.

First, we said we would refocus our strategy on four core businesses which have strong competitive positions. We also said we would grow revenues in our less market sensitive areas. And here, the underlying trends are encouraging, with positive drivers.

Second, we continue to work to reduce costs. We have reduced adjusted costs year on year, excluding the bank levy and transformation charges for the seventh quarter in a row, and we are on track to hit our full year 2019 target.

Third, our capital release unit is up and running and delivering. We made significant progress in reducing risk-weighted assets and leverage exposure in the quarter. We're confident of hitting our objectives for 2019 and beyond.

Finally, we told you that we would continue to manage our



balance sheet conservatively. In addition, our CET1 ratio was stable in the quarter and at the high end of our international peer group.

Slide 4 – Q3 2019 Group financial highlights

Let me now move to a summary of our group financial performance on slide four. Adjusting for specific items detailed on slide 24 of the presentation, revenues were € 5.4 billion in the quarter, as I will detail on the coming slides. Non-interest expenses were € 5.8 billion.

This includes 234 million of restructuring and severance and just under € 200 million of transformation related charges reported within our adjusted costs. Transformation charges in the quarter consisted primarily of software impairments as we implement our technology transformation to help reduce costs in future periods.

As we laid out in July, these charges will be part of our results for several quarters. Stripping out these charges, adjusted costs were € 5.2 billion, down 4% year on year. Provisions for credit losses of € 175 million remained within our target range and included a benefit of € 104 million.

This benefit reflected the net effect of our annual updates to the forward looking indicator element of our expected credit loss model and the regular quarterly update to the forward looking macroeconomic variables. Excluding these benefits, provisions for credit losses increased, reflecting lower recoveries and higher provisions taken on defaulted and impaired exposures.

Our net loss was € 832 million. The negative tax rate includes € 380 million of deferred tax asset valuation adjustments that we anticipated and communicated to you when we launched our strategy in July. We have redeployed some of our excess liquidity in the quarter which led to reductions in our liquidity reserves and liquidity coverage ratio, but both remain at healthy levels.

Slide 5 – Core Bank revenues essentially flat

Let us now look to the details of our revenue drivers, starting on slide five. On a reported basis, revenues declined by 15% year on year. The headline revenue development includes several factors that negatively impact the reported trends. If we adjust both the prior year and current year period for similar items which are extraneous to the core businesses, we see only 1%



year on year decline in revenues.

First, specific items including debt valuation adjustments as detailed on slide 24 of the appendix. Second, reported results were impacted by the capital release unit. The capital release unit generated approximately € 500 million of positive revenues in the third quarter of 2018 compared to negative revenues of around € 100 million in the current quarter excluding specific items.

Third, corporate and other revenues, including the impact of treasury items and valuation and timing differences were positive € 54 million in the prior year period compared to negative € 76 million this quarter. So adjusting for specific items, the capital release unit and corporate and other, revenues in our core operating businesses declined by 1% or € 35 million year on year. We view this as a resilient performance despite our far-reaching restructuring, the macroeconomic headwinds and additional interest rate pressures.

Slide 6 – Stabilizing revenues

Now, let me turn to the year on year revenue performance excluding specific items within our four core businesses on slide six. On this basis, investment bank revenues declined by 3%. However, across the majority of our investment bank, revenues either grew or were stable. We see this as a satisfactory result, given the uncertainty around our strategy at the start of the quarter.

Our transformation did have an impact on the performance in the investment bank, although the trends were in line with our internal targets and we believe that we are starting to put these issues behind us. Origination and advisory revenues grew strongly, with increases in both debt origination and M & A against a broader market that was flat.

Revenues also grew in our market leading financing businesses. As Dixit will discuss shortly, we continued to deploy balance sheet in our lending franchises within the investment bank. FX revenues were resilient in the face of further declines in market volatility.

A decline in revenues came from rates and emerging markets debt. The management teams in both businesses have taken action to stabilise the franchises. We are pleased with the early momentum that both showed at the end of the third quarter. We are committed to maintaining robust, broad-based rates and emerging markets platforms.



Revenues were marginally up year on year in total across our more controllable, less market sensitive businesses of asset management, the corporate bank and the private bank. These businesses accounted for over 70% of core bank revenues. In asset management, DWS showed its third sequential quarter of net inflows. Revenues were flat excluding the negative impact of lower interest rates on guarantees in certain retirement products.

In the corporate bank, we grew revenues 6% with growth across our global transaction banking and commercial banking units. And in the private bank, we offset most of the interest rate headwinds with solid growth in wealth management and our international business.

Slide 7 – On track to reach adjusted cost targets

Let me now turn to the progress we have made on cost reductions on slide seven. Stripping out transformation related charges, our adjusted costs were € 5.2 billion in the quarter. Excluding these charges and bank levies, we recorded our seventh consecutive quarter of year on year reductions.

Compared to the first quarter of 2018, we have reduced our quarterly adjusted costs by around € 450 million, or € 1.8 billion on an annualised basis. This quarter, we showed continued cost discipline with reductions in almost every category except for planned investments in technology.

The reductions we have achieved in the first nine months put us on track to deliver our full year target of € 21.5 billion. We expect to reach this target despite absorbing almost € 300 million of FX translation headwinds this year. And we remain committed to our longer term target of a cost base of € 17 billion.

Slide 8 – Progress deleveraging the Capital Release Unit

Turning to our progress in deleveraging in the capital release unit on slide eight. Our target is to reduce risk-weighted assets in the capital release unit by € 20 billion in 2019 to € 52 billion. We have just € 4 billion left to do in the fourth quarter to reach our target.

We reduced leverage exposure by € 73 billion and by over € 100 billion year to date. We are confident in reaching our full year target of reducing leverage exposure in the capital release unit to around € 120 billion.

Our leverage target assumes that we close the transfer



agreement with BNP Paribas for our prime finance and electronic equities platform in the fourth quarter. At the end of the third quarter, leverage exposure related to this transfer was € 40 billion. Roughly half of this amount should reduce soon after the closing of the agreement. The remainder, related to client balances, will transition over time.

Slide 9 – Key balance sheet and risk metrics remain strong

Before I hand over to Dixit, let me highlight that our key balance sheet and risk metrics remain strong, as you can see on slide nine. We have been managing our balance sheet conservatively and will keep doing so. Our common equity tier one ratio was 13.4%, unchanged from last quarter. The performance reflects the prudent way we manage our capital. It also shows our determination to fund our transformation from our existing resources.

We are also focused on maintaining strong credit quality. Provisions for credit losses are 15 basis points of loans year to date, a low level both historically and relative to peers that reflects our conservative underwriting standards, strong risk management and generally low-risk portfolios. Our loan to deposit ratio was 74%, reflecting a strong and stable funding base supporting our high quality and growing loan portfolio.

Finally, our liquidity position was strong. Our liquidity coverage ratio of 139% implies a surplus of € 59 billion. We will continue to maintain a prudent level of liquidity reserves at all times. With that, let me hand over to Dixit.

Slide 11 – Conservatively managed balance sheet

Dixit Joshi

Thank you James. Let me start with an overview of our net balance sheet that remains robust on slide 11. Here, we net down the IFRS balance sheet for items like derivatives netting agreements, cash collateral as well as pending settlement balances. This allows for a more comparable view to US GAAP.

Our net balance sheet declined by € 3 billion quarter on quarter, or over € 20 billion excluding FX effects, to slightly over € 1 trillion. Our liquidity reserves represent around a quarter of our net balance sheet. We continued to reduce our trading assets and grew loans over the quarter. The loan to deposit ratio increased by one percentage point, consistent with our continued balance sheet optimisation, and we expect to increase this ratio over time.



On the liability side, deposits rose slightly to € 585 billion, mainly driven by the corporate bank. Our long-term debt is down by € 6 billion on an FX neutral basis, as we reduced expensive sources of funding in line with our deleveraging. Let me provide further details around our year on year loan growth on slide 12.

Slide 12 – Loan growth to support revenue generation with conservative underwriting standards

A central part of our strategy is to reallocate resources towards our core businesses, including generating loan growth. In total, we grew loans by 6%, excluding the impact of FX translation. This lending was subject to our rigorous underwriting standards and fully consistent with the prudent liquidity deployment we signalled last year.

The 4% growth in our corporate bank was driven equally by growth in commercial banking in Germany as well as in global transaction banking. In GTB, growth was most notably in trade finance where loans are typically short term and to multinationals as well as to midcap corporates.

Lending in the investment bank grew 17%. We grew in asset-backed lending, mainly with investment grade rated new deals backed by a diversified range of assets, including corporate collateralised loan obligations as well as in autos and residential mortgages. We also increased commercial real estate-backed loans while continuing to apply conservative loan-to-value ratios and collateral protection.

The € 6 billion of growth in our private bank was mainly driven by wealth management where loans are typically collateralised. The growth in corporate and other reflects our initiatives within treasury to optimise and redeploy our liquidity reserves to support group profitability.

Within our central liquidity portfolio, we prudently invested into asset-backed securities, commercial real estate loans and equity margin loans. These investments are a high-quality, relatively liquid assets with low loan-to-value ratios. And finally, in line with our strategy, we reduced loans in the capital release unit by 27% or € 2 billion.

Slide 13 – Strong CET1 capital ratio maintained

Turning now to capital on slide 13. We are committed to maintaining our capital strength through our strategic transformation and we are encouraged by the initial results. In



the quarter, our de-risking efforts generated almost 45 basis points of capital, including approximately 20 basis points from lower operational risk which we realised one quarter earlier than planned.

Excluding operational risk, de-risking in the capital release unit generated almost 25 basis points of capital, offset by around 15 basis points of growth in the core bank and about five basis points of regulatory headwinds associated with the targeted review of internal models we have previously discussed.

Together with the negative impact of our transformation on earnings, our common equity tier one ratio was stable at 13.4%. We reaffirm our target to manage our common equity tier one ratio above 13% in the fourth quarter, with the decline versus the third quarter driven by multiple factors, including transformation charges and updates to pension liabilities, including tax effects.

We remain committed to keeping our CET1 ratio above 12.5% at all times. At this level, we will remain comfortably above our regulatory requirements and above our major European peers.

Slide 14 – Delivering on announced leverage exposure reductions

On slide 14, we show our leverage ratio which was stable at 3.9% in the quarter, despite a headwind from foreign exchange translation. On an exchange rate neutral basis, we reduced leverage exposure by € 39 billion, including € 77 billion of deleveraging in the capital release unit. This was partly offset by € 6 billion loan growth and a € 21 billion increase in trading assets. In the fourth quarter, we expect our leverage ratio to be 4%, rising to 4.5% by the end of 2020.

Slide 15 – Maintaining a solid liquidity profile

Slide 15 highlights our key liquidity metrics which remained solid over the quarter. Our liquidity coverage ratio surplus decreased by € 7 billion, driven by loan growth in our core businesses, supplemented by lending in our central liquidity portfolio and the retirement of expensive, long-term debt as part of our deleveraging actions. These initiatives led to a reduction in the LCR to 139%.

Our liquidity coverage ratio surplus above the 100% requirement remains at a comfortable € 59 billion. Liquidity reserves decreased slightly by € 3 billion. Securities declined



and cash within our reserves temporarily increased in the quarter, mainly reflecting deleveraging of our equities business in the capital release unit.

We expect to decrease the cash component over time and have reduced it by over € 30 billion year over year, driven by loan growth in our businesses, the central liquidity deployment and the reduced issuance plan. Looking ahead, we intend to prudently manage down aggregate liquidity reserves to a level slightly above € 200 billion and target an LCR ratio of approximately 130%.

Slide 16 – 2019 issuance plan

Moving onto our issuance activities on slide 16. By the end of the third quarter, we had issued € 10 billion with an additional € 2 billion of issuance competed in October, meaning that we are materially complete for our 2019 issuance requirements.

As a step in reducing our overall cost of funding, we plan to issue an inaugural tranche of our new structured covered bond during the fourth quarter, depending on market conditions. This covered bond programme optimally uses our available collateral of German retail mortgages that are not already part of our fund brief programme and has a higher overcollateralization than the traditional fund brief.

At our fixed income investor call early next year, we will provide more details around our 2020 issuance plan which, at this stage, we expect to be in line with our € 15 to €20 billion range laid out last quarter. We will monitor the market and maintain flexibility regarding pre-funding our issuance plan for next year.

Overall, the net redemptions in 2020, including TLTRO 2 maturities will continue to lower our overall funding footprint in line with our reduced balance sheet. In addition, we will keep the windows for TLTRO 3 participation in consideration as we optimise the cost of our overall funding stack. Note that the participation windows extend from September 2019 for seven quarters, into 2021, meaning we have optionality regarding timing.

Slide 17 – Outlook

Before moving to the Q & A, let me give you an outlook on relevant aspects for bondholders on slide 17. As we execute on our transformation agenda, we will continue to manage our balance sheet conservatively. In the capital release unit, we



have reduced leverage exposure by more than € 70 billion quarter over quarter. In the fourth quarter, we expect to see a substantial benefit from our agreement with BNP Paribas relating to prime finance and electronic equities.

We will not compromise on our strong liquidity position but aim to continue rebalancing the composition of our liquidity reserves. The reduction of our balance sheet also results in lower funding requirements. This quarter, we already see the benefit from retiring some expensive liabilities.

We expect to receive MREL requirements over the next weeks. Today, we already maintain a healthy buffer of € 17 billion. On a TLAC basis, the excess is even higher, at € 40 billion. The market expectations for forward interest rates present a headwind to our revenue aspirations for 2022 that we outlined in our July presentation. However, we have identified a series of mitigants to offset these headwinds.

First, the perimeter adjustments we announced with the second quarter results increase revenues in the core bank. Second, our businesses have begun more systematically pricing and charging for negative rates and the corporate bank and wealth management unit are well advanced, working with clients on this.

Third, we continue to deploy excess liquidity, including through the loan growth you have seen. And finally, the introduction of tiering by the ECB, which we had not assumed in July, should improve revenues by more than € 100 million per year.

So while the interest rate environment is challenging, it does not warrant a change in our 2022 revenue aspirations or return on tangible equity targets. With that, let us move to your questions.

Question & Answer Session

Robert Smalley (UBS)

Hi. Good morning Dixit and James, and thanks for doing the call. A couple of questions I had, first on slide 16. When we look at 2020, we've got a big slug of TLTRO 2 coming up. You've mentioned that. You've mentioned the flexibility in the third programme. But when you look at that kind of number, are you looking to replace all of that with the new plan? How does that fit in? And could you talk about how you think about the interplay between TLTRO 3, covered bonds and senior preferred debt? That's my first question.

Second, wanted to talk just a little bit about DTAs. It's more housekeeping. You had taken a write-down on some in prior quarters. Where do they reside? Are they, for lack of a better



word, portable? Can you utilise them in different jurisdictions? And will that drive any investment decision going forward? And then, third, if I could, I wanted to talk about some AT1s.

Dixit Joshi

Robert, hi. This is Dixit here. On TLTRO, we highlight that precisely because we will let some of that issuance run down through the course of the year and that's fully consistent with our deleveraging actions that we've commenced on. So over the next three years, we should expect to see a gradual rundown of issuance.

That said, given this is over nine quarters, we will remain somewhat opportunistic through that period. Some of the actions that we're taking including now are related to really TLTRO replacement in part. The structured covered bond and potential early redemptions of TLTRO 2 are actions that we would take to soak up liquidity through the period.

The second question that you had was really around senior preferred debt and covered bonds. Both of those will remain key tools in our funding mix through the course of the next few years. With an MREL surplus and we're expecting our MREL requirements for 2020 sometime in the next six to eight weeks, but with an MREL surplus of 17 billion, a TLAC surplus of 40, and with us comfortably meeting subordination requirements related to MREL, we're confident that we should see a greater proportion of covered bond and senior preferred debt issuance over time.

James von Moltke

And just quickly – Robert, good day to you – on the DTAs, in short, they are not portable. So they need to be utilised based on earnings in the jurisdictions in which they have arisen. As you've seen this year, we've taken significant valuation adjustments against our DTAs and so we feel ourselves to be in a much stronger position at this point in terms of our expectation of future utilisations.

Robert Smalley

Would that in any way have an influence on near-term investment, given the tax consequences of that and preference of one jurisdiction that holds DTAs versus others?

James von Moltke

Not really. We obviously engage in tax planning in the ordinary course. I wouldn't say that the existence of DTAs is necessarily proving to be a significant consideration in our strategic planning. I'd say that our strategic planning happens to line up with where the DTAs at this point still exist.

Robert Smalley

Okay. That's helpful. And then finally, on AT1s, on the slide on page 16, you've got contractual maturities but you do have a call on the 6.25 AT1s on April 30th. They're trading in an area that looks like the market doesn't anticipate that they'd be called. I



know these are things that you look at over time and you might not have gotten to it yet.

But given at least one other bank's experience when bonds were trading in that kind of area where the market had already acknowledged that they probably wouldn't be called, does that influence your decision at all? And how are you thinking about this now in terms of any kind of pre-funding or not pre-funding this call?

Dixit Joshi

Robert, we have been monitoring that security amongst all of our other AT1s and we do note that it trades well below par. With six months to go to the call date, it's somewhat premature to make a specific prediction. But as we said before, we would look at the economics, the replacement value of the transaction, any upcoming regulatory changes at the time in context prior to making a call decision and try and manage that communication with the market as we've done in the past in a responsible manner.

Robert Smalley

Okay. That's great. Thank you very much. Appreciate it and appreciate the call.

James von Moltke

Thank you Robert.

Lee Street (Citigroup)

Hello. Good afternoon. I've got three questions, please. Just firstly on the strategy, just if DB can't keep the revenue growth targets that you're setting yourself, to what extent do you think you'll be able to cut costs sufficiently to meet your return on tangible equity targets or do you have other levers that you can pull to try and hit those targets?

Just secondly, in the S & P write-up from last week, they specifically said in their RAC projection, they said it was partly based on DB returning to the AT1 market during 2020 to increase the amount of hybrids in their total adjusted capital calculation. So just obviously that's S & P's words, but any comments from you on that? Should we assume you're going to be actively issuing AT1 next year based on that?

And then just finally, I know it got mentioned on the call last week, the potential that your G-SIB requirement might reduce. Would you see that as being somewhat material in terms of reducing the amount of non-preferred senior that you might have outstanding going forward in terms of hitting your MREL and TLAC requirements? Or are the ratings considerations still more important there? They'd be my three questions, please. Thank you.



James von Moltke

So, it's James. I'll briefly cover the strategy question. Look, we're in the midst of our annual planning cycle. As Dixit indicated in his outlook commentary, we recognise some headwinds in the environment but have also been working on what the mitigants, what the offsets are.

And as we outlined, as this point, we don't see a reason to change our perspectives about the future. As you'd expect in every planning cycle, we look at each and every part of the plan – the top line expenses, also resources, and where we think we're headed from a CLP and other expenses perspective.

Of course, we will continue to look carefully at costs. However, when we initially announced our restructuring back in July, we felt that the target to take out approximately 25% of our cost base to get to the € 17 billion that we outlined for 2022 is ambitious. We'll always look carefully. But as things stand, we are working hard to execute on the plan that we outlined at that time.

Dixit Joshi

Lee, hi. I'll take the second two questions. On the first, on the AT1, we have indicated previously that we don't need at this stage any AT1 for next year. As you know, we have a surplus in the tier one bucket. It's something naturally we'd want to watch closely and not preclude any actions. But from a need perspective, we don't need to issue as we currently contemplate.

From a G-SIB perspective, with the reduction to 1.5%, that was largely a result of the last two or three years of restructuring, simplification of the firms, reduction of our balance sheet, reduction in intercompany flows and all of the other G-SIB metrics that contribute to the score.

With the reduction to 1.5%, where this will bear most fruit will be in 2021 when the CRR requirements around leverage ratio come into effect. And that would put us at a 3.75% minimum leverage ratio requirement. In the main, this would not affect really MREL, TLAC or senior non-preferred. And especially on the senior non-preferred side, a number of other considerations we would be managing to, including ratings agency considerations.

Lee Street

Okay. That's clear on all three of those. Thank you very much for your time.



Daniel David
(Autonomous)

Hi. Thanks for taking the time. I've got two questions on the ECB's recent liquidity stress test. First, has the process led you to rethink any of your limits reporting or systems and controls in the area? And second, can you give us a sense of how your USD liquidity profile compares to your Euro profile under the ECB's process?

Dixit Joshi

Daniel, hi. Naturally, I'd be somewhat constrained in what I can say, given this would be a regulatory dialogue between ourselves and our regulators. But to answer your first question on rethinking really limits and systems and data, this is an area where we've made significant investments over the last few years in our capabilities around whether it's modelling, the way we treat liquidity within entities that are trapped, fungibility, visibility.

And our general management and toolkit around liquidity is significantly enhanced compared to a few years ago and that, no doubt, helps us, whether directly in the stress test or otherwise.

We're quite comfortable with our currency profile, whether that's in Euros or in Dollars. It's always been part of our internal requirements, irrespective from the stress test requirements or LCR requirements. Our internal stress testing is of a much tighter level and we're quite comfortable with where we are on both those counts.

Daniel David

Thanks.

Jakub Lichwa (RBC)

Hi there. Thanks for holding the call. First question. Two questions, sorry. First question around MREL surplus. How much of that 17 billion do you actually view as a surplus and how much of this do you use for rating agencies' purposes, say, Moody's?

And second question is on slide 20, with regards to your Dollar AT1, 7.5%. I have an impression it's issued under foreign law. You are indicating that it's still eligible as AT1 capital obviously post-2022. But is it eligible post mid-2025, please? Thank you.

Dixit Joshi

Sure. And the first on the MREL surplus, on the € 17 billion surplus. We do maintain our debt stack to meet a number of internal and external requirements, including not just our regulatory requirements, whether that's MREL or TLAC, but also the ratings agency criteria, as you correctly point out. Given we meet much of the requirement with subordinated debt, that naturally works for both ratings agency criteria as well as the MREL surplus.



I think the change over the next few years for us will be to the extent that we continue to meet – which is our current anticipation – continue to meet the requirement through the subordinated debt that we have. We would have room to significantly uptick our senior issuance, whether that's covered bond or otherwise, over the next few years. So issuance of senior non-preferred consistent with both currently.

On the second, on the AT1, this was issued under US law but it does meet the requirements as we understand.

Jakub Lichwa

Okay, thank you.

Operator

There are no further questions at this time and I would like to hand back to Philip Teuchner for closing comments. Please go ahead.

Philip Teuchner

Thank you very much, Stewart, and thank you all for joining the call today. You know where the IR team is if you have further questions, and we look forward to speaking to you soon. Goodbye.

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