

ISSUER COMMENT

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Deutsche Bank AG and Commerzbank AG

Merger talks have no immediate rating implications

Last Sunday, [Deutsche Bank AG](#) (A3/A3 negative, ba1¹) and [Commerzbank AG](#) (A1/A1 stable, baa2), announced that they will engage in discussions about a potential merger. Both banks emphasized that these will be talks with an open outcome and that there is no certainty that any transaction will occur.

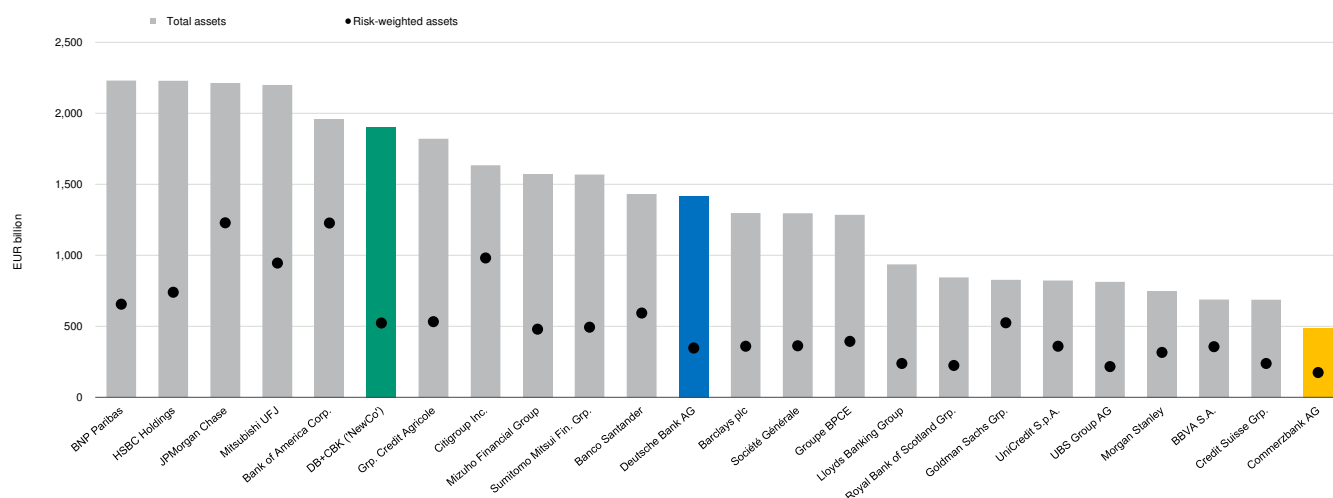
Since no further details were provided with regard to the potential structure and financing of such a deal, we continue to assess the potential credit benefits as well as impediments to such a combination by using [our hypothetical scenario analysis](#), first published on 27 February 2019. Should an actual transaction be announced, the structure, execution plan and risks may differ materially from the assumptions used in this scenario analysis and could result in a credit impact that is favourable, neutral, or negative, dependent on the terms of the transaction and post-combination execution.

If executed successfully, a combination has the potential to generate a positive return relative to its cost of capital longer-term. If the combined entity (NewCo) successfully cuts costs, safeguards revenue and manages to protect its franchise against persistently strong competition, its profitability could exceed the return levels anticipated under our central scenario, but may still remain below that of global peers. The earnings profile of the NewCo might also be more stable, because of its lower dependence on capital markets revenue. In addition, and despite certain overlaps, Commerzbank's corporate and small and medium enterprises (SME) banking businesses bring with them additional balance against Deutsche Bank's more volatile earnings streams from sales and trading. The NewCo would also continue to benefit from a strong retail and corporate deposit base, funding a large part of its net balance sheet.

Both banks are still undergoing deep restructuring programs. Despite much progress in de-risking and right-sizing, Deutsche Bank launched another strategic overhaul in 2018 to further rationalize its investment banking franchise, accelerate cost-cutting and stabilise earnings. Similarly, Commerzbank is entering the final stages of a multiyear restructuring announced in late 2016. Because the two banks are still executing on their standalone restructuring programs, a deal at this stage would likely delay progress on any ongoing and potential newly implemented restructuring plans. As a result, we would view the impediments to execution on such a deal as very significant. Nevertheless, if well executed, a transaction could create a dominant universal private-sector bank in Germany that could benefit the NewCo from a longer-term perspective of competitiveness and efficiency.

Exhibit 1

A Commerzbank / Deutsche Bank combination would place NewCo among the largest global banks by total assets
 Select Moody's-rated banks' total assets and risk-weighted assets as of 30 June 2018



Sources: Company reports, Moody's Investors Service

A deal would not immediately create a stronger institution. Incorporating assumed revenue attrition and cost savings entailed by a hypothetical deal, we forecast a net return on tangible equity (RoTE) of just below the NewCo's cost of capital, to be realized three years after closing. Our forecast carries major uncertainties regarding interest rate trends as well as revenue attrition in the NewCo's retail and corporate banking franchises, which overlap considerably in Germany. Larger 'cost-to-achieve' during integration would further leave the NewCo with limited opportunities to generate capital. A further unknown factor remains as to how much 'cost cutting' in the form of redundancies will be tolerated by the unions, which would be critical to a successful integration and achievement of peer level profitability over the longer-term.

Capital requirements would likely rise. The NewCo could have higher capital requirements than the banks' current standalone requirements, potentially because of a higher G-SIB buffer² and additional buffers that may be imposed by the German regulator. Since the deal could occur at a purchase price below tangible book value, the tangible capital of the acquirer would benefit from negative goodwill ('badwill') creation (which could be offset by several other factors such as the deduction of additional intangibles or fair value losses on acquired loan assets). This could – dependent on the terms of the deal – constrain capital ratios at the outset, limiting the NewCo's ability to meet rising regulatory requirements, exit unwanted businesses or seek new business.

Endnotes

- ¹ Unless stated otherwise, the ratings shown in this report are the banks' long-term deposit and long-term senior unsecured debt ratings together with their corresponding outlook(s), as well as their Baseline Credit Assessments (BCAs).
- ² Deutsche Bank's G-SIB buffer is currently 2.0%, with the maximum being 2.5%. The German regulator is allowed to add a systemic risk buffer of up to 5% of risk-weighted assets in the form of CET1 capital to avoid non-cyclical or macro-prudential risks that are not covered by the Capital Requirements Regulation (CRR).

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