

From: Richard Kahn <[REDACTED]>

To: "jeffrey E." <jeevacation@gmail.com>

Subject: Fwd: European Banks: DB: Stay High in the Debt Stack

Date: Fri, 30 Sep 2016 18:04:16 +0000

Attachments: EUROPEAN_20160930_0000.pdf

Inline-Images: ms-logo-138.png; header-research.png; product-logo.Idea.png; image001.png; image002.jpg; image003.jpg; check.png; mac_appstore_136_33.png; google-play_111-33.png; MarketingCampaign.jpg

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Begin forwarded message:

From: "Atlas, Andrew S" <[REDACTED]>

Subject: European Banks: DB: Stay High in the Debt Stack

Date: September 30, 2016 at 12:02:52 PM EDT

To: "Richard Kahn ([REDACTED])" <[REDACTED]>

Hey Rich,

Just wanted to wish you and the family Shanah Tovah!!!

Also attached a note Morgan Stanley Research published today on European Banks.

Hope to hear from you soon.

Best Always,
Andrew

Andrew S. Atlas
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European Banks

DB: Stay High in the Debt Stack

Europe

Jackie Ineke, Greg Case

September 30, 2016

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(PDF: 10 Pages)

We expect a settlement with the DoJ of ~\$6bn, ahead of the US election. In this scenario, we should see a rally across the debt structure, but with best risk/reward in the seniors, with Germany's subordination law not due until Jan 1, 17. We also add Tier 2 here, to benefit from any bounce.

We expect pragmatism to prevail with Deutsche attracting a ~\$6bn fine from the DoJ for its past actions in the primary RMBS market - though of course we acknowledge that there are high risks in

predicting the outcomes of judicial cases. A \$6bn fine would keep Deutsche's fully loaded CET1 ratio above 10.5%. At 2Q16 Deutsche had a 10.8% fully loaded CET1 (12.2% transitional) and €5.5bn of litigation provisions where we assume not all is earmarked for RMBS-related cases. On top of this Deutsche announced this week the completion of the sale of Abbey Life, netting an additional 10bp of CET1 and the bank stands to gain a further 40bp when its stake in HuaXia is finally sold. Management expects HuaXia to complete in 2H16.

There has been a wide range of outcomes for the banks that have settled so far. The read-across to Deutsche is made more difficult by the opacity of the alleged infractions and the different business model and market share of each defendant. The precedents so far were all primary market underwriters but some also owned retail originators, whereas Deutsche is largely a primary underwriter but has the added complication that its trustee business is involved too. On top of this complication, in previous cases the bid/ask spread between the DoJ's opening offer and the final result ranges from 34-84% of original ask.

Depending on the provision utilisation, a fine of \$6bn would take between zero and 135bp off Deutsche's CET1 ratio. For illustration, if one assumes €3bn of provisions are earmarked for the DoJ settlement, then the impact is 65bp on CET1, leaving DB with a CET1 ratio of 10.3% at 2Q16 pro-forma (inc. Abbey Life) and €2.5bn of litigation provisions for issues such as Russian mirror trades. We expect the market would rally on this outcome, as a potential near-term solvency event is taken off the table.

Seniors should be relatively safe, with the German senior subordination law due to take effect from January 1, 17. This leaves senior still difficult to bail-in legally in 2016, in our view, and with €18bn of sub debt below it and the systemic issues a senior bail-in would cause, we don't imagine the SRB/ECB will want to enforce losses, and also believe state aid rules would allow for this discretion. Given our expectations of a manageable settlement, we believe Tier 2 also offers decent value here and should rally with seniors but offering less downside protection. In AT1, we prefer to stay away from the bonds, despite our constructive short-term view. ADI is still a material risk for coupon payments and YTPs only look like fair value to us - in line with peers like RBS and Unicredit.

Prior DoJ RMBS Settlements - a \$6bn fine would represent a 43% settlement for Deutsche, well below that of Citi

Trade Recommendations

- Buy Deutsche Bank seniors and Tier 2
- Continue to avoid Deutsche Bank AT1
- For full details, pricing and risks see end

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