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HD **Deutsche Bank on road to reform**

BY James Eyers and Anne Hyland
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Deutsche Bank's head of corporate banking and securities, Robert Rankin, has warned that investment banks will rack up more fines and penalties this year for misconduct, but claims the industry has curbed the behaviour that led to the global financial crisis after engaging in a long process of cultural reform.

Mr Rankin, one of the most senior Australians in global banking, described the past 18 months as "certainly the most challenging of my career" as Europe's largest investment bank re-focused its business mix and dealt with investigations and litigation relating to the subprime crisis.

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In December, Deutsche announced it was withdrawing from its commodities business, which had become less profitable under new global regulatory rules, and also paid US regulators $US1.9 **billion** (about $2.1 **billion**) to settle claims it defrauded US government-controlled Fannie Mae and Freddie Mac in the **sale** of mortgage-backed securities.

Mr Rankin said it was right that investment banks are held to account for misdeeds, given the significant value destruction the GFC caused for shareholders. Implementing cultural reform to prevent a repeat of these incidents was the issue that Deutsche's senior management team had spent the most time on over the past year, he said.

"We as an industry have had to go on a big cultural reform agenda and in some ways that's been the hardest [management task]," Mr Rankin said in an exclusive interview with The Australian Financial Review during his recent visit to Australia.

"As an industry, we lost connectivity with the societies in which we operate and with our clients. There was a disconnection there and a breakdown of trust that needed to be rebuilt as an industry. The big investment banks were a core part of that and that was felt more acutely in the US, Europe and particularly the United Kingdom, where the impact of the financial crisis on society was significant.

"We've been rightly held to a high level of account and the industry's shareholders have paid a lot for that. We've had to go on a very consistent and long journey of cultural reform, which I personally have been very committed to."

In a global research report on the outlook for global banks in 2014 published last month, UBS said litigation risk was "a theme that will persist in the coming quarters and. . . for several years".

"While related provisioning costs and ongoing uncertainty have been an overhang, we think there could be more settlements in cases such as Libor and mortgage issues in the coming quarters," Mr Rankin said.

In two significant areas – Libor and US mortgages – very significant costs have been incurred by the industry. Litigation will continue to be an ongoing material cost for the investment banking industry and we don't make forecasts around that," he said. litigation reserves of €4.1 **billion**

At its 3Q results for 2013, released on October 29, Deutsche reported an additional provision in its litigation reserves of €1.2 billion ($1.8 billion) in the quarter, taking its litigation reserves to €4.1 billion.

Following the $US1.9 billion December settlement, Deutsche last week settled a separate suit in the US after shareholders accused it of misrepresenting its ability to handle risks associated with mortgage debt prior to the 2008 financial crisis (Deutsche has exited the mortgage businesses that gave rise to the claims).

The bank has also been among the global banks accused of manipulating the benchmark Libor interest rate and its European sister benchmark, Euribor. According to an article published on Sunday in German magazine Der Spiegel, the German banking watchdog, BaFin, has been critical of Deutsche management for the way it responded to a probe into the manipulation of Libor.

The bank denies any current or former member of the management board had any inappropriate involvement in Libor rigging.

Much of the misconduct exposed by the various legal cases and investigations against a range of investment banks has provided global regulators with added motivation to impose more stringent regulation on the sector, including capital requirements and leverage ratios.

Regulatory uncertainty would persist for at least another six months, Mr Rankin said, adding the warning that divergent regulatory schemes in Europe and the United States would add complexity and costs.

The comments preceded a report in The Financial Times on Monday which said the European Commission was considering a more narrowly defined version of the US Volcker rule, which bans proprietary trading, and that Europe may not force banks to automatically split their lending and risky trading operations.

"What would be bad for us is a lack of symmetry, or material asymmetry, across the Atlantic between the US and Europe," Mr Rankin said.

"We've continued to push the view that it's not in anyone's interest to have a nationalistic led regulatory asymmetry between the US and Europe. Everything we've seen so far would lead us to be confident that's not the case.

"By the [European] summer of 2014, I think we will know what the new norm looks like." leverage ratios a key regulatory theme in 2014

During the course of last year, the regulatory debate moved from capital to leverage, or the extent to which financial institutions should be allowed to borrow relative to their total balance sheets. In its report, UBS said leverage ratios will remain a key regulatory theme in 2014, and "in Europe, higher leveraging requirements will likely be a bottleneck for many banks' growth ambitions and dividend payouts".

Mr Rankin acknowledged that Deutsche had more work to do on the leverage ratio.

"We've got an external target of reducing Capital Requirements Directive 4 [which implements Basel III capital accords in Europe] assets by €250 billion by December 2015. The capital and leverage journey continues and we feel really comfortable and confident with the progress we've made."

Deutsche's underlying cost income ratio for the investment bank is running broadly in line with its 65 per cent target from an underlying perspective. The new regulatory landscape is also forcing global investment banks to make bold decisions about their mix of businesses.

In December, Deutsche said it would cut 200 jobs worldwide as it abandoned most of its commodities trading business. "Most of the investment banks have pulled back from commodities trading during the course of the year. This was driven in part by the Volcker rule considerations," Mr Rankin said.

Tighter regulation has also forced investment banks, including UBS, to largely withdraw from fixed income operations.

Mr Rankin said Deutsche had been a beneficiary of this consolidation but that fixed income, currencies and commodities (FICC) was no longer as profitable given the new capital requirements.

"The top five or six globally systemic players in fixed income have undoubtedly taken market share during this period," he said. "It's increased market share of a smaller pie. That's offset by more capital that we've got to have supporting the business and the increased cost of regulation and complexity as well."

Deutsche Bank analysts have estimated European investment banking fees fell 6 per cent in 2013, with fixed income, currencies and commodities desks shouldering most of the decline.equities the star

At its 3Q results for 2013, the corporate banking and securities division reported income before tax of €345 million, with revenue down 26 per cent year-on-year. Mr Rankin said fixed income had had a tougher second half in 2013, but this had been offset by equities, which he described as the "star performing business" last year.

Equity capital markets work across the bank was up close to 40 per cent off a low base year-on-year.

Debt origination business, both investment grade and high yield, also performed strongly.

Mr Rankin said US markets remained buoyant; they would account for in excess of 50 per cent of Deutsche's fee pool this year for the first time in a decade.

"We're cautiously optimistic about fixed income, particularly the work we've done on cost, capital and leverage. We're optimistic on the outlook for equities. We believe corporates have got more courageous."

Mergers and acquisitions was down across the bank year-on-year, but Mr Rankin said the M&A pipeline had "not looked as good as it has in the last six months for many years".

"It's not back to boom times but there's been a steady pick-up."

In Australia, Deutsche ranked No.7 in Dealogic's completed M&A rankings for the full 2013 year – Deutsche Bank advised Rio Tinto on the sale of its $1 billion stake in Clermont thermal coalmine to Glencore-Xstrata; Transpacific Industries Group on the sale of its New Zealand waste management unit; and Dexus on its takeover bid for the Commonwealth Property Office Fund – and was outside the top 10 in equity capital markets.

Fixed income work – including debt origination, fixed income and currency trading for clients – accounts for around two-thirds of Deutsche's local revenue.

"We are the leading foreign player here in foreign exchange and rates and have brought huge amounts of global capital into this market. The bank has had a very strong business here for a long time, albeit in less visible parts of the business than the league table businesses that some of our other competitors have been stronger at from time to time."

Deutsche, who will be led in Australia from next month by outgoing Goldman Sachs managing director James McMurdo, was the lead arranger of Kangaroo bonds (those issued by offshore borrowers into the Australian market) in 2013, overtaking TD Securities and Royal Bank of Canada.

In the year to December 19, Deutsche Bank had acted as sole or joint lead manager on 43 Kangaroo transactions worth $8.93 billion.trading in the renminbi a huge priority

Deutsche Bank has been in the Asia Pacific region since 1872 (two years after it was founded), when it opened an office in Shanghai. Today, it sources nearly one-fifth of its investment banking revenues from the Asia-Pacific region.

Mr Rankin said capital markets in Asia would continue to deepen and that trading in the renminbi (RMB) was "a huge priority for us".

"The history of Deutsche Bank is linked to the emergence of the euro. We think the RMB will be a significant reserve-type currency for the world. This is a trend we want to be involved in and leverage our platform into," Mr Rankin said.

"If you believe, as I do, that China will become the largest economy in the world some time in the next 20 years, and that as financial markets deepen and become more sophisticated alongside that, and trade flow intra-regionally grows, this region will become increasingly important to banks like us.

"The core macro driver of a billion people-plus coming into the middle classes in Asia in the next 20 years is going to have a dramatic impact on capital flows, trade flows, wealth flows, intellectual capital flows.

"A country of 24 million people uniquely positioned in that time zone has a very bright future. That's a core belief."

Before his appointment to the group executive committee in March 2012, Mr Rankin was Deutsche's chief executive officer for the Asia-Pacific (excluding Japan), based in **Hong Kong**.

Prior to joining Deutsche, he was head of investment banking for Asia Pacific at UBS, where he was also a member of the UBS Asia Pacific management committee and the UBS investment banking board.

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