Deutsche Bank AG

Deutsche Bank Q3 2022 Fixed Income Conference Call

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Transcript

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RICHARD STEWART

Slide 1 – Ongoing business momentum in line with 2022 targets

- It is a pleasure to be discussing our third-quarter and nine-month results with you today
- We continue to operate in a difficult and uncertain environment. We are mindful that the economic impacts of the war in Ukraine and the energy crisis are yet to be fully seen. However, despite these challenges, we are progressing towards the completion of our transformation strategy
- Our efforts continue to be recognized by our stakeholders, as we saw with the rating upgrade from Moody's earlier this month
- We delivered our highest third quarter pre-tax profit since 2006, and our best nine-month result since 2011, as we work towards our 2022 financial goals
- Turning first to our performance: the positive trends we saw in the first half of the year continued in the third quarter
- We delivered Group revenues of 20.9 billion euros in the first nine months, an increase of 7% year on year
- We also achieved revenue growth of 10% year on year across the four core businesses, driven by business volume growth, market share gains, improving interest rates and business investments
- Our cost/income ratio was 73% for the first nine months, down from 82% in the prior-year period
- In the first nine months of 2022, we generated an 8% return on tangible equity, in line with our target and up from 4.8% in the first nine months of 2021
- We also proved our resilience. We maintained strong risk management in this challenging business environment. Provision for credit losses was higher, but contained, at 24 basis points of average loans
- We are well capitalized: We finished the third quarter with a Common Equity Tier 1 capital ratio of 13.3%
- Now let me take you through the progress in our core businesses, on slide 2

Slide 2 – Core businesses delivering strong results

- All four core businesses delivered strong post-tax return on tangible equity in the first nine months

- In the Corporate Bank, revenues are up 20% year to date, thanks to further improving interest rates and higher fee income, supported by volume growth in loans and deposits
- Return on tangible equity was 11%, a four-percentage point increase year on year
- In the Investment Bank, continued client engagement and strong risk management in our leading FIC franchise drove revenue growth of 8%, with particular strength in our macro trading businesses
- The Investment Bank delivered a return on tangible equity of 12%, despite lower Origination & Advisory activity, as markets became more volatile
- The Private Bank boosted its return on tangible equity to 9.5% by delivering a more-than-threefold increase in pre-tax profit in the first nine months
- Asset Management delivered revenue growth of 4% year on year, proving its resilience in a much tougher market environment

Slide 3 – Risk management actions support stable risk profile

- Let me now spend some time talking to our risk management and balance sheet strength, on slide 3
- As always, we remain extremely focused on disciplined risk management
- We constantly monitor and manage risks through our early identification systems, multiple downside analyses and stress tests and selective limit reductions
- We proactively responded to the escalating war in Ukraine and the broader European energy crisis via focused hedging and selectively reducing risk appetite in our focus portfolios
- Our underwriting standards remain robust, even as we continue to support clients through these challenging times
- Our approach and our resilient balance sheet mean we have seen limited impacts on our risk profile so far. Our key risk and balance sheet metrics have remained stable since the fourth quarter of 2021, before the start of the war in Ukraine
- Our provision for credit losses increased to 24 basis points of average loans for the first nine months, compared to 8 basis points for the same

period last year. This is the normalization we expected following a less benign macroeconomic environment compared to the previous year

- Nonetheless, we still expect the full year provision to be in line with our overall earlier guidance, at around 25 basis points
- Overall, our credit portfolio quality is broadly stable and, despite the volatility we have seen, our market risk is managed within our appetite parameters, and we have taken measures to protect us against tail risk

Slide 4 – Significant improvement in pre-provision profit

- Turning to slide 4, which illustrates the improved profitability that we believe positions us well in face of a tougher macro-economic outlook and more challenging credit environment
- The Core Bank delivered a return on tangible equity of 10% in the first nine months, up from 7.5% in 2021, and in line with our 2022 target of greater than 9%
- As a result, Core Bank pre-provision profit rose 40% year on year to 6.4 billion euros in the first nine months
- And pre-provision profit is not only higher, but also better diversified across our franchise
- The contribution from our stable businesses has increased significantly; the Corporate Bank, Private Bank and Asset Management now account for over 60% of pre-provision profits
- And with the turn in the interest rate cycle, we expect the contributions from our Corporate Bank and Private Bank to remain sustainably strong in future periods

Slide 5 – Strong loan & deposit development

- Let us now look at topics that drive our revenue performance over the next slides
- Slide 5 provides further details on the development in our loan and deposit books over the quarter
- We have been successfully delivering on our strategy of growing our lending books as part of the overall growth in our stable businesses and to reduce surplus liquidity

- With liquidity now around target levels, we are beginning to shift to a more balanced loan and deposit growth pattern in order to fund continued growth while maintaining sufficiently prudent liquidity levels
- Loan growth across the bank has been 10 billion euros in the third quarter or 2 billion euros on an FX adjusted basis
- We saw continued strong momentum from collateralized lending in our Private Bank and sustained client demand across our FIC franchise, while loans in Origination & Advisory remained flat
- Given the current economic outlook, we are very focused on actively managing our risk profile and ensuring a disciplined approach in underwriting new business, particularly in structured lending
- Deposits grew by 10 billion euros compared to the previous quarter when adjusting for FX
- This growth has been primarily driven by corporate clients holding higher cash reserves amidst a more challenging macro environment
- We expect to see continued volatility in corporate deposits as economic uncertainties keep impacting our clients, as well as muted growth in retail deposits due to inflationary pressures on consumers
- At the same time, deposit margins have started to increase following recent interest rate hikes, a trend that based on current forward curves will continue

Slide 6 – Continuing positive trend in net interest margin

- Let me now provide some detail on the evolution of our net interest margin on slide 6
- As we flagged to you last quarter, our NIM trend continues to remain positive, in line with rising interest rates
- The NIM increase was driven both by Euro and Dollar rates, with Euro rates now starting to play a bigger role
- The NIM increase was also driven by approximately 5 basis points of positive one-offs, most notably from the buyback of our senior non-preferred debt, offsetting the positive one-offs we flagged for the second quarter
- Average interest earning assets rose reflecting US dollar strengthening and underlying loan growth

- Interest rate tailwinds have increased since the second quarter with benefits now significantly above 3 billion euros in 2025 compared to our 2021 baseline, however wider funding spreads will have an offsetting impact if they persist at these levels
- The net impact remains materially better than the impact we flagged to you at the IDD back in March

Slide 7 – NII sensitivity shows incremental revenue upside

- Let me now give you some additional details on net interest income sensitivity on slide 7
- Further increases in rates above current market-implied levels will continue to add to the interest-rate-driven tailwind
- Over time, the largest impact will come from long-end rates as we roll over our hedge portfolios to higher levels, particularly in Euro
- Currently, we see our deposit repricing lower than our beta assumptions, and this effect in part drives the higher sensitivity at the shorter end
- Over time, we would expect betas to converge closer to our model assumptions

Slide 8 – Strong liquidity position in-line with targets

- Moving to slide 8, highlighting the development of our key liquidity metrics
- We have maintained our solid liquidity and funding position despite continued volatility in asset markets
- The stock of our high-quality liquid assets increased by about 20 billion euros during the third quarter
- This is mainly due to continued deposit growth primarily driven by the Corporate Bank and net new capital market issuances
- This was partially offset by loan growth particularly in Private Bank
- As a result, the liquidity coverage ratio increased by three percentage points to 136%
- The surplus above minimum requirements increased by about 9 billion euros quarter on quarter to 60 billion euros

- Our average daily liquidity coverage ratio over the past three months was at about 134% and underlines stability and proactive steering of the balance sheet in line with target levels
- While we remain committed to support the business growth, we continue to manage the LCR conservatively towards 130% for the remainder of this year
- The net stable funding ratio remains at 116%, which is within our target range
- The surplus of 85 billion euros remains comfortably above the 100% requirement
- The available longer-term stable funding sources for the bank remain well-diversified and continue benefiting from a solid deposit franchise, which contributes about two thirds to the Group's stable funding sources
- We aim to maintain this funding mix, which will be supplemented by longer-dated capital market issuances in line with our issuance plan

<u>Slide 9 – CET1 ratio increase driven by risk profile and earnings</u>

- Turning to capital on slide 9
- Our Common Equity Tier 1 ratio ended at 13.3%, 37 basis points higher compared to the previous quarter
- CET1 capital increased in the quarter adding 13 basis points
- Strong organic capital generation net of deductions for dividend and Additional Tier 1 coupon payments added 24 basis points
- This was offset by 9 basis points for slightly higher other deductions
- The second element of driving the strong ratio were lower risk weighted assets contributing around 24 basis points
- Almost half of this is attributable to market risk, where we have seen very low VaR and sVaR levels early in the quarter which picked up towards the end of the quarter with increased client activity
- The rest is attributable to credit risk and operational risk. In credit risk, the reduction is driven by modest growth in stable businesses which is more than offset by tight risk management in the Investment Bank

Slide 10 – Capital ratios well above regulatory requirements

- Our capital ratios remain well above regulatory requirements as shown on slide 10
- In-line with the CET1 capital ratio development in the quarter, the distance to the CET1 ratio capital requirement has increased by 36 basis points and now stands at 289 basis points or 11 billion euros of CET1 capital
- Our available AT1 and Tier 2 capital is at or slightly above the respective regulatory requirements, which brings our Total Capital ratio distance to MDA to 304 basis points
- This provides us with a comfortable starting point as we manage through the coming quarters

Slide 11 – Leverage ratio unchanged

- Moving to slide 11
- Our leverage ratio was 4.3%, unchanged over the quarter
- Increased Tier 1 capital added 4 basis points driven by strong third quarter earnings net of deductions for dividends and AT1 coupons
- 1 basis point came from essentially flat leverage exposure
- For the quarter, FX translation effects led to a 3 basis point reduction in our Tier 1 leverage ratio. The corresponding effect year to date was a reduction of 9 basis points

Slide 12 – Significant buffer over loss-absorbing capacity requirements

- We continue to operate with a significant loss-absorbing capacity, well above all our requirements, as shown on slide 12
- The MREL surplus, as our most binding constraint, has increased by 4 billion euros to 19 billion euros over the quarter
- The increase was driven by higher regulatory capital and new issuances of eligible liabilities, which were partly offset by two successful public tender offerings and further roll-downs during the quarter
- Our loss-absorbing capacity buffer remains at a comfortable level and continues to provide us with the flexibility to pause issuing new eligible liabilities instruments for approximately one year

- This buffer also allows us to maintain the one notch uplift in our senior non-preferred rating from Moody's based on their Loss-Given-Failure methodology over and above the improved Baseline Credit Assessment following the most recent upgrade
- We intend to maintain the LGF notch for the foreseeable future, certainly at the current rating level

Slide 13 – Issuance plan close to complete

- Moving now to our issuance plan on slide 13
- The quarter was characterized by ongoing challenging market conditions with high levels of interest rate and credit spread volatility
- In this context, we are pleased to being largely complete in terms of 2022 issuance requirements
- Since the last FI call at the end of July, we issued a total 4.7 billion euros, taking the year-to-date total to close to 19 billion euros
- I would note that this total is slightly inflated due to 2.7 billion euros of structured notes which were not part of the original funding plan
- This activity is being moved into the Investment Bank
- Notable in the quarter were a dual-tranche Pfandbrief issue along with a senior non-preferred issuance in both Euros and Sing-Dollars
- The 5 and 10 year Pfandbrief issuances secure attractive funding levels for the bank and we further diversified our investor base through the inaugural Sing-Dollar issuance
- In August and September, we completed two public market tenders in Euros, Sterling, and US dollars for a total amount of 2.1 billion euros
- In the two transactions, we bought back 1.1bn in Euro and Sterling bonds, and 1 billion Dollar bonds
- The tenders tightened our credit spreads in all three currencies and supported our NIM by around five basis points as mentioned earlier
- We continue to guide to roughly 20 billion euros of issuance for full year 2022 and may consider some prefunding for 2023 in Q4, depending on market conditions

Slide 14 – Outlook

- Turning to the outlook on slide 14
- We believe our strong performance in the Core Bank in the past nine months is a testament to the quality of our businesses and the strength of our franchise
- Reflecting on this performance, we see upside to our 2022 revenue guidance of 26 to 27 billion euros, particularly given the trends we see in our stable businesses
- Business momentum in the past nine months, combined with improving operating leverage, makes us even more confident in the delivery of our 2022 strategy and financial goals
- We continue to adhere to strict risk management principles, particularly in this continued uncertain environment
- We are very focused on managing our resilient balance sheet and we confirm that we expect our provision for credit losses at around 25 basis points of average loans for the full year
- As I mentioned earlier, our credit ratings were upgraded by Moody's earlier this month, following the upgrades of the three big agencies in 2021
- We expect this to have a positive impact on both our issuance spreads and business volumes, specifically in the Investment Bank and Corporate Bank, over time
- On the issuance side, we have almost completed our funding requirements for this year and remain flexible to pre-fund our requirements for next year
- The funding plan for 2023 will be presented at the Q4 Fixed Income Call in early February
- With that I will finish and we look forward to your questions

Question and answer session

Brajesh Kumar (Societe Generale)	Good afternoon and welcome, Richard. This is Brajesh from SocGen. I’ve got three questions, if I may. First, in light of the changes to TLTRO, do you intend to repay tranches earlier than expected? And how is this, in general, the ECB announcement affecting your funding plans? I know that we have numbers for 2022, but I will appreciate any colour on your future plans. The second one is more generic. Looking at yesterday's various ECB announcements, what is your general view and guidance expected and the impact on the rate guidance that you provided us? Anything you want to add? And finally, how are you looking at asset quality in 2023? Are you seeing any kind of straining of the loan book? I would love to get your thoughts out here. I think that's it.
Richard Stewart	Thanks Brajesh, and welcome and thank you for joining. I think I'll take the first question on TLTRO, and then maybe I'll just hand it over to James for his overall thoughts on yesterday's announcements. So, in terms of the changes to TLTRO and the impact on our funding plan, the ECB announcement will not have an impact as TLTRO’s longer-dated tranches remain an economic source of term funding. As we have noted repeatedly, TLTRO was an important source of financial support for the European economy, and not an arbitrage opportunity. DB’s funding plan was designed around a smooth amortisation of reliance on TLTRO, and this profile remains unaffected by Thursday's decisions. We are reviewing the extent to which we prepay the earliest tranches, but these will not be prepaid in full, as these are also supporting client transactions, which may not be beneficial to unwind early. James, perhaps you want to just talk about you overall thoughts.
James von Moltke	Yes, thank you, Richard. I think the rate decision by and large was in-line with market expectations, and therefore fits with the earlier outlook we provided for

our rate sensitivity and the path of net interest income from here. The market is still trying to find the right balance between their assessment of the dovishness or hawkishness of the Central Banks which you have seen a little bit yesterday and today, since the announcement. For us, it is reasonably in-line with our expectations.

I have to say, on the TLTRO decision, we are deeply disappointed by the decision. To have retrospectively amended the terms of a monetary policy instrument that has over two trillions of balances in it, to our mind, is a spectacularly large mulligan to have taken for themselves. The banks entered into these instruments in good faith, with the intention of supporting lending into the economy.

That lending has been committed to clients, and I think most banks met the hurdles that were implicit in the instrument. And the banks are now harmed in two or three different ways going forward economically.

First, there is the loss of the of the additional benefit from the original terms that will flow into earnings in the next several years. That would have supported profitability, organic capital generation, and the ability of the banks to support the economy and what will undoubtedly be a difficult time.

Secondly, when that funding went into the economy, it influenced asset spreads. And so, we live with the asset spreads that were entered into at that point in time. And that will be with us, even as rates rise, that will be with us for some time.

And lastly TLTRO was built into the ALM modelling of the banks and therefore, the hedging was done. And now I think banks could have potentially significant costs in addition, unwinding the hedging that was done. And if you take a step back from the economic costs, the implicit contract that existed around TLTRO and think about the path forward, banks will now have to assess the reliability of long-term actions / long-term policy tools and how we take those up, how we hedge them, how we build them into our risk modelling in a way that wouldn't have been the case, had they left those terms unchanged.

So, we have, I think, a strong reaction to that part of yesterday's announcement, Brajesh.

Brajesh Kumar (Societe Generale)	Super. And any views on asset quality in 2023?
James von Moltke	Yes, thank you for the reminder. So, on Wednesday, our guidance was look, we think the normalised rate of CLPs is in a range between 20 and 25 basis points for our portfolio. Looking to next year, I think, at this point, again, it's very early to judge this, but I would expect us to be at the high end of that range, maybe a couple of basis points above it, but still with a reasonably sanguine view of the portfolio quality we have and the condition of households and corporates, going into, what we're obviously aware, will be a more difficult economic environment But again, it's part of our underwriting discipline that we try to build a portfolio that will withstand a market cycle, and our hope and expectation is that the portfolio will perform according to our modelling.
Brajesh Kumar (Societe Generale)	And just one last bit of clarification. I see that in your slides, you have still got three to four billion for AT1/T2 tier versus year-to-date issuance of three billion. So, does this mean you're keeping the optionality open to come to an AT1/T2 market, if the need be? Should I read like that?
Richard Stewart	I think that's a reasonable assumption. I think, as you say, we've successfully done our issuance plan for the year. But as I guess with all frequent issuers, we always look at things, whether they make sense for us, given the opportunity we see within the firm to grow assets at a satisfactory level. So, yes, there's a chance that we may look to do something in the coming quarters.

Iuliana Golub (Goldman Sachs)	Good afternoon. Thank you. Three questions, please. The first one on the ratings. Do you expect any move from S&P to upgrade your ratings as a follow-up from the move from Moody's earlier in October? Then two questions on capital. Given the increase in MDA in 2023, do you also intend to update your target CET1 ratio? The minimum 12.5% would look a bit out of sync, if you have an MDA of around 11%. And then has there been any progress in the convergence between the ICAAP and the regulatory reported ratios regimes? Or do you very much continue to manage the group to both regimes? And lastly, on Tier 2, could you please describe how you look at the economics of refinancing of Tier 2 debt? And maybe any indications around refi costs. Should we look at the refi costs to the reset level? Thank you.
Richard Stewart	Thanks, Iuliana. I guess taking your first question, which I think is around the S&P rating upgrade potential. So, I'd say first of all, were very pleased with the upgrade from Moody's. That's the second from them within the last 14 months, which I think is a strong signal that our transformation is successful, and we're on the right track towards a sustainable, profitable bank. In addition, as you know, Fitch confirmed our positive outlook in September. We know what is expected from us from them to move that rating level, and we're focused on delivering. And then ultimately, we are hopeful that we will also see something similar from S&P, and they will recognise progress the bank has made over the last couple of years. So, yes, I guess we're hopeful. We see the positive movement from the other rating agencies, and we hope they'll follow through with S&P.
James von Moltke	Iuliana, it's James on the capital questions. Firstly, yes, the 12. 5% that we've operated under for the past several years has been a minimum that we've wanted to maintain, also in stress conditions, given we were

travelling through a period of restructuring and transformation. But as we began to indicate at the investor deep dive in March, our thinking is evolving towards maintaining a minimum gap to MDA, and hence, the guidance that we've given to 13 recently, in recent quarters.

And so, it is certainly evolving, and we'd like to maintain an appropriate gap, call it 200 basis points, to MDA, as MDA develops. Next year, as you'll recall, the countercyclical buffer and the sectoral buffer become binding in February. And so, that, of course, begins to enter into our thinking.

On the ICAAP or economic capital measures, I will say that over the past several quarters and years, as we've seen the impact of model changes, methodology changes, rule changes, and as that continues now through to 2025, we've observed in the past that there's a divergence between our regulatory capital requirements and our economic capital requirements.

The former, continuing to increase, while the latter, we're managing relatively flat. Obviously, it grows somewhat as the balance sheet grows, but the capital intensity of our business, on a relative basis, hasn't been significantly fluctuating. So, we clearly manage it and it's something we're always mindful of, and we are observing a trend of divergence between the two with the regulatory being the most binding.

Richard Stewart

And maybe if I pick up your Tier 2 call strategy. I guess how we think about these things is how we always think about all our calls, which is that they will continue to make decisions regarding the exercise of an issue, a call right, close to the exercise date, balancing the interests of our stakeholders.

Our approach is based on economic factors, including the usefulness of the instrument for capital, funding ratio, agency metrics, as well as the cost of the instrument versus alternatives. So, that strategy remains consistent and we'll apply that to any

	upcoming calls that should come in.
Soumya Sarkar (Barclays)	Hello. Thank you for hosting the call and welcome to Richard. I have two questions, if I could. First, you say that you were still committed to the leverage ratio target of 4.5% by the end of 2022. Does it still imply that we will see a tick up from the current 4.3%? And with that, have additional AT1 issuance as part of the plan? And my second question, on your deposit development, you mentioned that you expect lower growth in retail deposits going ahead. And we can see that their corporate deposits have increased. Is that a trend you expect to see to continue in 2023? And how does that affect your margins going ahead as well? Thank you.
Richard Stewart	Thanks, Soumya. Taking your leverage ratio question first, maybe to start off with, obviously AT1 is one tool in the toolkit that we can use to manage leverage, if we so wish. But as you said, we finished Q3 at 4.3%. We are comfortable achieving a leverage ratio of around 4.5% for 2022. And, as I think I also said earlier was that we have seen a nine basis point drag, year-to-date, on our leverage ratio from FX effects. We might not fully compensate those FX effects through leverage exposure reductions immediately, if we felt that that was going to have a negative impact on some of our business lines, where we see some profit opportunities still. So, overall, we still, like I said, we're pretty confident of achieving that leverage ratio of around 4.5%, but just bearing in mind that that FX effect as well.
James von Moltke	And Soumya, it’s James on deposits. We've seen reasonably encouraging and steady growth in the deposit books over the past several quarters. And at least so far, no apparent moderation of that, nor, to be fair, an excessive competition for deposits in our markets. And so, while one would expect this to begin to tail off, as liquidity drains out of the system and the

	actions of central banks, particularly QT, begin to take effect, we haven't seen that impact so far. Incidentally, the other item that would probably draw down deposits in the system is just household usage, as they go through the impact of higher energy costs and what have you. So, while all of that is a change in dynamic that we would expect to see, it hasn't been visible so far, and at this point, hasn't fed into deposit pricing in a notable way.
Corinne Cunningham (Autonomous)	Good afternoon and nice to meet you, Richard. A couple of follow-ups on the liquidity point. What type of collateral have you pledged behind TLTRO? And I wonder if you could guide us to what would your LCR look like, if you were to redeem at the first opportunity in November?
Richard Stewart	Thanks, Corinne, and very nice to meet you. It’s a good question. We’re working you through what we want to do there, but I'll say around two thirds of our collateral is illiquid and that supports our liquidity coverage ratio. This would have a € 30 billion impact on our LCR, if that we were to lose that instantaneously. But as you know, we stagger the tranches out until up to 2024, so we're not going to be doing any pre-payments immediately. But like I said earlier, I think we have a pretty well contained amortisation profile, which we're managing and making sure that we can continue to fund those clients.
Lee Street (Citigroup)	Hello. Thanks for the call. Thanks for letting me ask some questions. Three, please. I think, on the results there, the guidance was for revenues of in excess of 28 billion next year. Any detail or thoughts on what rate assumptions underlie that? Secondly, as it relates to group risk rated assets, how should one be thinking about them evolving over the course of next year from current levels? Higher, flat, lower, any data around that would be helpful? And finally, you've got a 19 billion headroom to your MREL requirement presently. What's the minimum you

might look to run at, in terms of hedging them? I'm asking the question really, obviously, you did some buybacks that seem to have quite a big impact on the margin. So, I'm just wondering if we can get an idea of whether there could be more capacity for that included there. They would be my three questions. Thank you.

James von Moltke

Sure. Lee, it's James. I'll start on the first and probably part of the second, and Richard can take over on RWA and MREL, if he has other things to add on the RWA side. The 28 billion we guided to, Christian went through, if you'd like, a walk, thinking about the core businesses that we operate, essentially, the run rates that they are exhibiting, at this point in time and that we expect in Q4. So, the step-off that we have.

There is growth outside of interest rates, so volume related growth, that one would hope we can achieve in the businesses. But then there's also a support from interest rates. To your question, we look at the implied forward rates, we look at the curve, basically, that the market shows, and we plan off that. So, that's visible to you, as it is to us. We think there's about 1.1 to 1.2 billion of upside in 2023, relative to 2022, from interest rates.

And that's just the impact of the curve on a static balance sheet. And interest rates, by themselves, will be much higher than that, but then we adjust out higher funding costs, non-repetition of some of the favourable factors that we had in 2022, and also, the impact of TLTRO, which we spoke about earlier, which is where some of the benefits are rolling off.

And compared to our earlier planning, we have less favourable rates on TLTRO. So, the net of that was call it somewhere between a billion and 1.2 billion to support for revenues next year. So, all things equal, the current run-rates would deliver that, along with interest rates. RWA are trending higher. We are working to support business growth, support clients with our balance sheet.

But we need to, obviously, calibrate the RWA that we can give the businesses to the capital plan and our goals going forward. And there again, I refer you to the investor day materials from March, where our capital plan now accommodates three things.

One is distributions to shareholders, the other is supporting the business growth, in other words, RWA, and the third is building the ratio over the next two years, 2023 and 2024 towards the Basel III environment that we anticipate in 2025. So, wanting to make sure, essentially, solve for a ratio on 1st January 25 that is still at the 13% after giving effect to the Basel III changes.

Richard Stewart

And then on the on the MREL side of things, like you say, we've got a buffer of 19 billion or so, and that generally allows us the flexibility to pause issuing new senior non-preferred or senior preferred instruments, which is for about a year, which is why we like holding the buffer.

But also, the subordinated part of MREL is something that we want to ensure that we can target the loss given failure ratios that Moody's set. So, it allows us to send that strong message around the rating to our to our investors.

Robert Smalley (UBS)

Hi. Thanks very much for doing the call. Welcome, Richard. Three questions. First, on asset quality. With respect to movement into stage one, stage two, stage three, I'm assuming that stage three will continue to be episodic. But could you give us an idea of where you see the trajectory of movement from stage one into stage two? And if that changed, what concern would you have?

And what kind of trajectory would cause you concern, in terms of the change and movement through the categories? That's my first question. The second question, with respect to funding overall. US peers have been struggling with their balance sheet size around their securities business, given more customer facilitation. The business as usual balance sheet is a little bigger.

Then you've got stress coming in there on the risk management side, so there's a greater need for liquidity. How does that play into your plans for issuance next year and how do you look at that? And then, lastly, on the call the other day, it was mentioned a couple of times that you think your spreads are too wide. I agree, particularly given recent upgrades and results. Besides doing liability management and calls like this, what else are you planning on doing to pull in your spreads?

James von Moltke

Hi, Robert, thank you for joining again. Those are tough questions. On asset quality, it's hard to tell you what level of deterioration we're comfortable with. And obviously, it's a fact of life that there's some deterioration in a book. In general, in recent quarters, the downgrade upgrade relationship has been relatively stable, if I think about it, in terms of the mix the, the limits, where we've seen upgrades versus downgrades, based on our internal rating.

In a deteriorating macro-economic environment, of course, that relationship will change somewhat, but you'd prefer to see it be gradual than it accelerates at pace. And as we mentioned on Wednesday, one of the things we're seeing at the moment is that most of the forward-looking indicators haven't yet started demonstrating stress, including, for example, that that upgrade downgrade ratio.

So, it’s hard to give you a sense of what level of movement would begin to cause us concern. You're right that stage three is on impairment events, so it'll always be somewhat episodic. I wouldn't expect the run rates, at this point, necessarily to change dramatically from where we've been over the last several quarters, so we'd like for it to remain within a range.

Stage one and two depends on two things in particular. Economic variables, there, we might see some more deterioration as we get closer into the into the recessionary environment. And then at some point, you'd see it begin to pull out, as those macroeconomic indicators look forward to recovery. But the other dynamic we've got is the portfolio parameters.

And there, this quarter, you had this very interesting behaviour that the general portfolio improvement that was taking place on PD and LGD variables, that fed into our stage one and two results, driving the unusually low outcome, and actually, offsetting much of the macroeconomic variable related deterioration.

On the impact. So, moving to your US peers question, it's an interesting change in the environment that the availability of, call it, a leveraged balance sheet may be becoming more constrained again. We've got a level of leverage that we think we're generally comfortable with. As Richard outlined, we're giving a lot of thought to how much leverage to run against our ratio targets and the available capital.

But going into the year end, it's one feature that may impact the market, that unlike the previous years, the US banks may be less generous with their leveraged balance sheet. Right now, I'll defer to Richard on whether we're really building that into issuance plans for next year, but we're waiting to see what the impact is over a year end.

Richard Stewart

Thanks, James. So, I think there are a few things in your questions. So, maybe I'll start with your observation of spreads being too wide. We concur with that assessment. One of our strategic objectives is to align to have consistency across the rating agency spectrum. We're obviously seeing that positive movement in Moody's. Fitch, we think, is going in the same direction.

But I think there's a discrepancy with those two, and S&P is one of the things that's holding us back a little bit, so we'll continue to work with S&P to make our case. But ultimately, we just have to keep following through on what we've been doing, which is just executing on our transformation, building organic capital, and that gives you the equity buffer and that will be positive for the debt stack.

So, ultimately, that's what we have to do, but those are the levers that we're pulling. And I think just the strategy is working, and so, we're seeing that organic capital continue to be built. So, I think I'll start with that. And therefore, I think we are seeing the same sort of effects that our US peers are seeing, in terms of client demand for the balance sheet. So, we obviously manage that carefully.

We do target our LCR of a target of 130%, and that will continue to be our target, which we'll manage through this quarter and subsequent quarters. And I think we're doing a pretty good job of steering that. And I think we ended up being quite balanced, really, in terms of that incremental loan growth demand, as well as being able to match that with stable funding.

So, I think when you look at the issuance plan, it’s on slide 13 of the materials, then you can see a pretty consistent picture for this year, next year, and the outer years that we're not looking to do anything, grow anything outsized on the issuance side. And as to your point are these levels, then, it's something we have to be very mindful of, in terms of whether we want to be pursuing this issuance plan, unless internally, we can generate returns to justify that.

Robert Smalley (UBS)

That's great. I appreciate the thoroughness. Thank you.

Philip Teuchner

Just to finish up, thank you all for joining us today. You know where the IR team is, if you have any further questions, and we look forward to talking to you soon again. Goodbye.

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