

## US FBO – More Time Afforded

### Alert: First Take on US FBO Rules

**US FBO Rules Announced** – The Federal Reserve Board has announced the final rules for FBOs (foreign bank organisations), which aim to achieve greater parity between FBO IHCs (intermediate holding companies) and US BHCs (bank holding companies). The enhanced standards cover a number of areas, including capital, leverage, liquidity, single counterparty credit limits as well as stress-testing. The key risks were: (i) capital strengthening; (ii) related balance sheet deleveraging & potential earnings impact; and *most importantly* (iii) liquidity and source of funding. Our first take follows albeit subject to clarification from the banks and other experts.

**Funding Risk Contained** – The memo highlights that: “*The foreign proposal would not have imposed a cap on cross-border intragroup flows.*” Taken at face value, this would reduce the key risk of having to fund the US operation locally & at wider spreads vs. more attractively priced cross-border funding. For example, we had estimated this potential risk at €250m pre-tax earnings impact for DBK.

**Capital Raise or Downstream?** – The draft final rule “*would not recognize alternative forms of capital that do not meet the criteria for capital instruments*” for US BHCs. Although this would likely exclude the use of contingent capital instruments, we would not exclude the possibility of using AT1-style instruments with perpetual, non-cumulative terms subscribed by the parent company; this would avoid raising more expensive, external capital. In practice, the longer implementation period should allow most banks to meet capital needs via retained earnings, DTA usage, capital injections from parent etc. Our understanding, is also that leverage requirements, including the generally applicable leverage ratio of 4% and for US IHCs with >US\$250bn of total consolidated assets, the minimum supplementary ratio of 3%. In practice, FBOs may run to a generally applicable leverage ratio of c5% (ie on-balance sheet, excluding add-ons) to reflect stress buffers and mitigate for early remedial actions.

**Timing Extended** – The *initial* compliance date for FBOs has been extended by one year to 1 July 2016. The final rule also “*generally delays application of leverage capital requirements to the US IHC*” until January 1, 2018. This is consistent with the timing of the US SLR (Supplementary Leverage Ratio) – refer to our [US Leverage, European Read-through: Path to Greater Clarity](#) report (7 July 2013). With leverage ratio as the key capital constraint, this should ‘afford’ time to limit the potential ‘dilutive’ impact of meeting the new FBO requirements. The key unknown remains the impact of the US stress-tests.

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**Kinner Lakhani**

+44-20-7986-4258

kinner.lakhani@citi.com

**Andrew Coombs**

+44-20-7986-4053

andrew.coombs@citi.com

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## Deutsche Bank

(DBKGn.DE; €35.90; 1)

### Valuation

We have a €45 price target for Deutsche Bank based on a DDM methodology using a 'normalised' RoTE of c14.5% and a cost of equity of 11.6%. We also incorporate a capital shortfall of €7.4bn based on a capital gap for a 4% leverage ratio.

### Risks

The key risks to our investment thesis on Deutsche Bank are: (1) the size of provisions related to the assets, which are dependent on the macro scenario; (2) the realised level of organic capital generation over the coming quarters, additional regulatory requirements or litigation provisions, which will determine any need to raise capital; (3) the pace of the turnaround in the asset & wealth management operation; and (4) the resilience of capital market revenues.

If any of these risk factors has a greater downside impact than we anticipate, the share price will likely have difficulty attaining our target price.

## Appendix A-1

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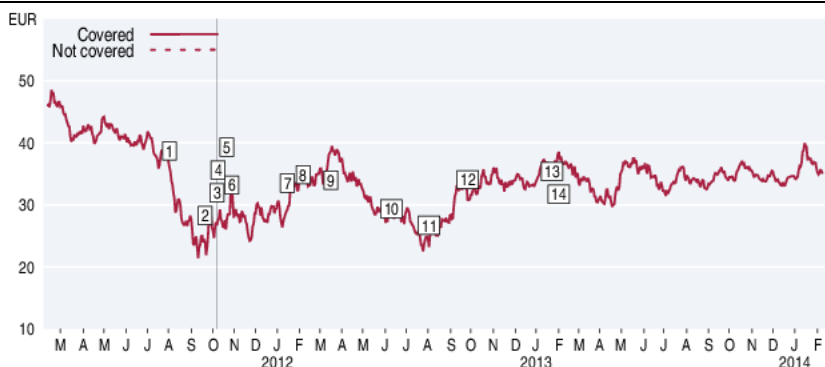
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Analyst: Kinner Lakhani



	Date	Rating	Target Price	Closing Price
1	2-Aug-11	2H	*43.00	36.08
2	21-Sep-11	2H	*28.00	23.90
3	7-Oct-11	Stock rating system changed		
4	8-Oct-11	*2	28.00	26.73
5	21-Oct-11	2	*26.50	27.83

\* Indicates change

	Date	Rating	Target Price	Closing Price
6	28-Oct-11	2	*32.50	33.20
7	16-Jan-12	2	*30.00	29.22
8	7-Feb-12	2	*35.00	33.95
9	16-Mar-12	2	*39.00	38.67
10	11-Jun-12	2	*33.00	28.39

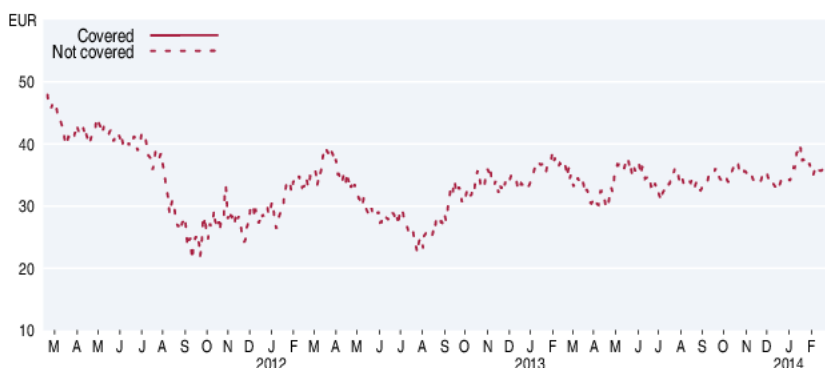
	Date	Rating	Target Price	Closing Price
11	2-Aug-12	2	*28.00	23.21
12	26-Sep-12	2	*33.00	30.67
13	23-Jan-13	2	*39.00	35.40
14	1-Feb-13	*1	*45.00	38.53

Rating/target price changes above reflect Eastern Standard Time

#### Deutsche Bank (DBKGn.DE)

##### Ratings and Target Price History Best Ideas Research Relative Call (3 Month)

Analyst: Kinner Lakhani



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