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Deutsche Bank Trading Losses Reveal Industry Setback (Update1)

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By Aaron Kirchfeld and Jacqueline Simmons



Jan. 12 (Bloomberg) -- **Anshu Jain**, who helped generate about half of **Deutsche Bank AG's** earnings in 2007 as co-head of investment banking, is winding down buying and selling debt for the bank's own account after at least \$1.5 billion of losses. As **Jain** retreats from what was the most-profitable part of Wall Street during the past six years, the securities industry is preparing to report its worst quarterly trading results.

Germany's largest bank lost about \$1 billion from bad bets involving bonds hedged by credit-default swaps, plus \$500 million trading equities, two people with knowledge of the matter said. The Frankfurt-based company may post a **fourth-quarter loss**, partly as a result of the trades at Jain's unit, analysts estimate.

Goldman Sachs Group Inc., Morgan Stanley, JPMorgan Chase & Co. and **Credit Suisse Group AG** also have reported trading losses after the September bankruptcy of New York-based Lehman Brothers Holdings Inc. All the banks, except Goldman Sachs, have said they are shutting down some proprietary-trading operations.

"The financial crisis has caught up with Deutsche Bank," said **Lutz Roehmeyer**, who helps manage about \$17 billion at Landesbank Berlin Investment in Berlin, including Deutsche Bank shares. "The bank needs to reduce risk and scale back prop trading to adapt to changing conditions. After the collapse of Lehman, even the best hedging in the world doesn't help."

That **Deutsche Bank**, which made more money trading debt than all competitors except Goldman Sachs in 2007, could wind up reporting the first annual loss at its securities unit in at least nine years, as analysts estimate, shows how the company failed to fully skirt dire trading conditions. Jain, 46, declined to comment ahead of the release of fourth-quarter results on Feb. 5.

Subprime Meltdown

Goldman Sachs and **JPMorgan** of New York, which along with Deutsche Bank mostly sidestepped the meltdown of the U.S. subprime mortgage market, face losses as investment-grade bonds had the worst performance in at least 35 years and stock markets headed for their biggest rout.

Deutsche Bank Chief Executive Officer **Josef Ackermann**, 60, said in late December that he underestimated the severity of the crisis. His counterpart at JPMorgan, **Jamie Dimon**, called November and December "terrible" for businesses including trading.

Goldman Sachs, the world's most profitable securities firm last year, had a fourth-quarter loss of \$2.1 billion, its first since going public in 1999. The firm's fixed-income, currencies and commodities unit posted negative revenue of \$3.4 billion, "indicative of a tough trading environment," Keefe, Bruyette & Woods Ltd. analyst **Matthew Clark** wrote in a Dec. 17 report.

'Hard Time'

Credit Suisse, the second-biggest Swiss bank, said Dec. 4 it will eliminate 5,300 jobs after about 3 billion Swiss francs (\$2.7 billion) of losses in the previous two months. The Zurich-based company said the investment bank posted a "significant" pretax loss in October and November.

"The markets in which these instruments are traded are essentially closed," said **William Fitzpatrick**, an equity analyst at Optique Capital Management in Milwaukee, which oversees \$1 billion. "It's not like you could take the other side of a position or make a good call. There's no market to participate in. I have a hard time seeing any meaningful revenue coming out of the prop-trading desks of any of the major banks."

The world's biggest banks and brokerages have reported more than \$1 trillion in writedowns and credit losses since the beginning of 2007, forcing them to raise about \$946 billion of capital, data compiled by Bloomberg show.

Weinstein's Group

Deutsche Bank lost \$1 billion from proprietary credit bets in the fourth quarter in a unit led by the New York-based co-head of global credit trading, **Boaz Weinstein**, people familiar with the matter said on Dec. 12. Weinstein plans to leave the firm with about 15 of his colleagues in the second quarter to start a hedge fund, the company said on Jan. 9.

The departure comes as **Deutsche Bank** shut down the proprietary credit desk, known as Saba, and combined the remaining investments with the regular trading operations. Weinstein, 35, has been with the bank 11 years, and his team earned between \$600 million and \$700 million in 2007, said two people with knowledge of the matter. The losses in the equity proprietary-trading unit, which will be scaled back, were outside Weinstein's group.

The fourth-quarter deficit occurred after a 1.26 billion-euro (\$1.7 billion) loss trading credit and equities for the firm's account in the third quarter. Ackermann, in a letter to employees on Nov. 21, said he'll "recalibrate" the business, moving costs and assets away from areas unlikely to recover in the near term, and certain propriety trading activities.

'Significant' Loss

Deutsche Bank follows **JPMorgan** in scaling back proprietary trading. The second-largest U.S. bank shut down its 75-person global proprietary trading desk during the fourth quarter. **Credit Suisse** has said it will reduce operations in complex products and exit some proprietary trading.

"In the current environment, where every asset class is under pressure, it's almost impossible to not have trading losses," JPMorgan analyst **Kian Abouhossein** said in an interview last week. "But prop-trading losses are worse than hedging losses because management made a conscious decision on taking risk positions."

Deutsche Bank's investment banking division, which Jain oversees with **Michael Cohrs**, 52, generated 28 percent of total revenue in the first nine months of last year, hurt by writedowns and lower trading, compared with 54 percent in the same period in 2007. Consumer banking generated the most revenue of any unit in the first three quarters of 2008.

A decline in revenue from structured products has been partially offset by gains in foreign-exchange and commodities trading, areas in which Deutsche Bank is investing and hiring.

Job Cuts

Jaipur, India-born Jain is forgoing his 2008 bonus, along with Ackermann and other **company executives**. His global markets unit plans to shed about 900 employees, or 15 percent of the division's workforce of about 6,000, people familiar with the matter said in November.

"In the past, Jain's business was making the most money for the bank, and he was considered a possible heir to Ackermann," said **Konrad Becker**, a Munich-based analyst at Merck Finck & Co.

The financial strains may force Deutsche Bank, the most leveraged of Europe's largest banks, to ask investors for more funds, said Morgan Stanley analyst **Huw van Steenis**, who recommends selling the company's shares.

Ackermann aims to shrink Deutsche Bank's assets and reduce the company's dependence on borrowed money to avoid raising funds from investors or taking a handout from the government. Deutsche Bank set a goal of cutting the bank's **leverage ratio** -- total assets divided by shareholder equity, using U.S. accounting principles for derivatives -- to 30 times by the end of the first quarter from 38 times at the end of June.

Trading Risk

Deutsche Bank's leverage ratio is more than double the level at **Goldman Sachs**, the world's No. 1 adviser on mergers and acquisitions, and London-based **Barclays Plc**, according to a Dec. 16 note from Van Steenis.

The bank improved its tier 1 ratio, used to assess a bank's ability to absorb loan losses, to 10.3 percent at the end of the third quarter.

"We do recognize Deutsche has outstanding management and has managed risks far better than most banks," Van Steenis said. "However, with such widespread asset deflation, illiquid credit markets and little appetite for cheap capital raises, we think the risks of expensive dilution remain high."

Van Steenis, who's based in London, forecast a capital increase of at least 6.5 billion euros, adding that Deutsche Bank also may cut the **dividend** and shrink its balance sheet. That's only a little higher than what JPMorgan's Abouhossein said the company may need to raise.

"The share price implies it's not a question of if, but when," Abouhossein said. **Deutsche Bank** dropped 69 percent last year in Frankfurt trading. The company's market value is now 13.9 billion euros.

Capital Needs

Ackermann reiterated on Nov. 21 that the company doesn't need **capital** from the country's bank-rescue fund, called Soffin, and instead will rely on "internal measures" such as selling stock. The plan not to seek government aid is unchanged, a person close to the matter said last week.

Commerzbank AG, Germany's second-biggest lender, announced Jan. 9 that it will get a second bailout of 10 billion euros from the government, which will take a 25 percent stake.

Deutsche Bank moved on Dec. 17 to pass up an opportunity to redeem 1 billion euros of bonds indicates funding conditions for banks remain tight, according to Credit Suisse analyst **Daniel Davies** in London. The company said at the time that the decision was made because "replacement costs would be more expensive."

The company is "pulling all levers" to avoid the need to raise capital, said **Dirk Hoffmann-Becking**, a London-based analyst at Sanford C. Bernstein & Co.

Helpful Accounting

The bank marked down assets less aggressively than many U.S. banks and Swiss rivals **UBS AG** and Credit Suisse, according to Abouhossein. Deutsche Bank may book 3.9 billion euros of fourth-quarter writedowns, the most among European banks, based on mark-to-market valuations of all structured credit assets, as commercial property and assets backed by bond insurers tumble, he said.

The markdowns may vary because of new accounting rules that ease requirements for reducing the value of investments such as leveraged loans and commercial real estate, Abouhossein said. Deutsche Bank posted net income of 435 million euros in the **third quarter**, helped by the accounting regulations.

The German bank so far has reported writedowns of about 8.5 billion euros. That compares with \$49 billion at Zurich-based UBS and \$67 billion at New York's **Citigroup Inc.**, according to Bloomberg data.

"Deutsche Bank started out in an excellent position, but could have been more aggressive at marking down assets and raising capital," said Abouhossein.

Consumer Banking

Ackermann, speaking in an interview with Germany's ARD television on Dec. 29, said he "absolutely" underestimated the severity of the crisis and had expected markets to improve. "This was abruptly ended by the collapse of Lehman, and since then it's been really, really bad," he said.

Ackermann, who declined to comment, has been expanding the company's so-called stable businesses. He bought a 30 percent stake in **Deutsche Postbank AG**, Germany's biggest consumer bank by clients, to cut dependence on the securities unit. Still, pretax profit from consumer banking, asset management and global transaction banking fell by almost half in the third quarter.

Jain, at a Euromoney conference in London in July, said he believed the financial industry needed a repricing of risk after the "very rapid" accumulation of leverage bloated the price of assets. The subprime mortgage collapse was the "trigger" for the reversal, Jain said at the time.

Credit Rating Cut

Deutsche Bank's **credit rating** was lowered by Standard & Poor's on Dec. 19 to A+ from AA- on expectations of "weak" trading results in the fourth quarter and a potential "significant" reduction in 2009 pretax profits compared with 2007 levels.

Less than a third of the **43 analysts** who cover Deutsche Bank recommend investors buy the stock, with the rest split between hold and sell ratings, according to Bloomberg data. By comparison, almost 40 percent of analysts covering UBS and Credit Suisse recommend investors buy the stock.

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