COMMERZBANK

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Transcript

Marcus Chromik CRO

The bank at your side

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Marcus Chromik, CRO

Ladies and Gentlemen,

Without doubt, these are challenging times and not only for risk managers. The list of current risk factors is extensive:
Climate crisis, trade conflicts, low interest rates, digitalisation, and, of course, COVID.

Each individual risk is already complex, volatile, and capable to initiate severe problems. It has become ever more difficult to identify individual causes and accurately predict the consequences of potential crises. This holds even more true for the pandemic. We still don't know, how far we are through the most severe crisis of this century, so far. As yet, we don't know how efficient the vaccination process will be. How the mutation of the virus will develop. In what timeframe and in what way. Above all, as yet, we don't know the full extent of the damage to the global – and local – economies and whether COVID will cause even more harm to the economy.

On top of this, while being in survival mode through the pandemic, companies are facing a huge transformation towards digitalization and ESG at the same time. We are at the start of a decade of decisive importance. It's not only about the world with COVID, but also about the world after COVID.

As the Chief Risk Officer of Commerzbank, it's my duty to safeguard the bank's capital and liquidity and to ensure that the bank is resilient at all times. I firmly believe Commerzbank has two main components for its resilience:

- First, we have a very well underwritten loan book, which focuses on the core economies. We are in close contact with our customers and understand their needs and the risks they're facing. We know precisely how to help them.
- Second, with our strategy 2024 we have developed a plan with a significant distance of the capital ratio to the MDA.
  This allows us – in case of a deviation from the plan due to, - for example, COVID worsening – to buffer for uncertain events that may arise in the future.

Therefore, being the CRO of a German bank and of Commerzbank is not the worst job for a CRO these days.

- Germany has the strongest economy in the eurozone.
- The unemployment rate and debt ratio are well below the EU average.
- Our house prices are stable.
- And our GDP has shown a high resilience towards the COVID Crisis – not least due to the comprehensive aid programs for the economy provided by the government.

Our risk assumptions are in line with the ECB analyse and expect GDP to rise by 3%, somewhat more conservative than our own economists. We are benefiting from the fact that our clients operate in Germany and other attractive economies in the heart of Europe. 75% of our loan book is allocated here. Over the last few years we have rigorously reduced non-core industries such as Commercial Real Estate, Shipping and various emerging markets businesses which are struggling right now.

Instead, we've focused on the German Mittelstand as our core business. Our low risk appetite is reflected in our internal ratings: ~85% of our exposure is taken with investment grade clients. But also other near term parameters show resilience. Our NPE ratio of 1.0% is low compared to other European banks. Volume of moratoria was low throughout the crisis. As of June 2020, the volume for corporate and private clients stood at 1.6% and is nearly gone by now. Migrations and overdrafts indicate robustness.
This crisis has clearly proven the advantage and importance of our long-standing client relationships. The so-called house-bank-principle is based on a trusting and open dialogue. Dialogue for me has been key to working with our clients through the pandemic. As an example, in advance of Germany's first lockdown in March our credit officers and risk specialists examined our client portfolio for their potential impact due to the pandemic.

It started with the simple question: Which clients are depended on production in – or export from Wuhan in China?
Information you do not have in any of your data bases. So, we approached more than 1,000 customers for a risk assessment. Subsequently, we've been able to determine the pandemic's direct and indirect impact on production, business, and supply chain matters. Our expertise and our long-established bank-client-relationships have allowed us to act quickly and professionally in supporting our clients in this difficult and dynamically shifting market environment. We help our clients identify the right tools to assist them and we issue every loan that we can prudently approve. As such, we can manage our risk position and support our customers during this unprecedented crisis.

Now, let's have a look at the 2020 risk result and how Covid is showing itself in our books. We booked loan loss provisions of €1.75 billion, which we break down in three buckets.

- First, our base risk result of almost €790 million covers all losses which would probably have occurred without the crisis anyway.
- Second, we've booked more than €450 million for loan losses where we could clearly identify the COVID impact.
- And third, €505 million comprises our Top Level Adjustments, TLA.

Why do we book a TLA? Imagine you are sailing against a strong wind force of - Beaufort scale of 7, and you know there's a heavy storm approaching. What do you do? You can shorten the mainsail and reduce the surface. For the time being your boat seems safer. You are sailing with a small sail and 7 beaufort. But the storm is still out there. Most of our customer – which do not belong to the immediate affected sectors – did the same. From retail customers to corporates. We see customers bunkering liquidity. By using programs or in most cases spending less. Investments are on hold. These cushions sometimes even support the rating. But the storm is still coming. Only if the storm is gone, you will see the real damage for example rating migration with a time delay. That's why we've built TLAs in 2020.

As of today, we expect that the current TLA covers the effects of the 2nd lockdown. Overall - we've booked ~€960 million in order to cover expected impacts of COVID.

Without doubt, a significantly higher probability of default can be assumed for industries and sectors such as tourism, hospitality and some retail which we know will be affected. We currently assume that we will see at least around four times as many insolvencies in 2021 as in the previous year. On the one hand, this is due to the fairly low number in 2020. On the other hand, the disruption and speed of change in recent months have been so radical that some business models are now fundamentally challenged. And allow me the comment as a risk manager. If the existing or even tighter lockdown measures are extended beyond March, we cannot rule out further TLAs.

Depending on the industry and company, there will be very different development paths. Areas such as technology, health, online trade and digital services will move forward with a lot of tail-wind. However, aviation and tourism will certainly need a longer time to reach the pre-crisis level. For those industries hit hard by the crisis, it will take a long time - if at all - to reach pre-crisis levels.

The TLA that we've built is almost equally split among the core corporate portfolios: Mittelstand, International Clients and Small Business Customers. In our Private Client portfolio we don't expect a lot of COVID-related defaults. Because the unemployment rate remains low, thanks to the allowances for part-time working.

On this slide you can see the development of the different stages over the course of the year. There weren't significant movements between stages 1 and 2 yet. However, our rationale for booking TLAs in 2020 is that we will see the impact of altered parameters within the models with some time delay. We booked the top-level adjustments for the performing portfolio, mainly stage 2, in order to assure sufficient coverage of potential COVID effects. Pandemic related downgrades, including stage migrations in 2021, are also anticipated. From 2022 onwards we expect a normalisation of the risk environment.

As you can see, our customers have come through the crisis quite well, so far. Most deferrals we allow for in 2020 ended according to the schedule. More than 97% of our customers have so far resumed their payments. This figure surprised me positively if you allow me that comments. We will closely monitor those loans that are or have been under moratoria. Loans under moratorium represent currently only 0.2% of our group loan portfolio. With our healthy risk profile and comfortable capital ratio, we see ourselves well equipped to manage this current COVID situation.

Overall the non-performing loan portfolio is actively managed within – what we call – our intensive care unit. The non-performing exposure is stable around 1% of our overall loan portfolio. In addition, the overall rating score of the entire loan book is stable due to the cautious measures clients take.

After years of relatively benign economic conditions with historical low risk results, risk costs went up because of the Covid pandemic. Despite the impact of COVID, we expect loan loss provision to go down to below €1.2 billion. From 2022 onwards we are positive that the risk result will reach more normalized levels. LLPs will arrive at pre-crisis levels slightly below the expected loss again by 2024 at the latest.

It doesn't need me to tell you that I don't have a crystal ball into the future. Looking at our strategy for me as a CRO it is foremost important that we continue to have a substantial distance to the MDA which gives us comfort. I started my speech by saying - It's not only about the world <u>with</u> COVID, but also about the world <u>after</u> COVID.

Germany and Europe are in a decade of decisive importance which requires significant investments and innovations.
Our economic strength is largely based on the efficiency of German industry – the Mittlestand – and, above all, its ability to innovate. Companies not only have to cope with the short-term consequences of the pandemic crisis, but also have to invest to fundamentally transform their business models. Commerzbank can play a crucial role here.

Especially with regard to those companies that have a viable business model, but who are unable to finance the pay back of state aid and their transformation at the same time. We need to

develop solutions to create opportunities for investments. For example, joint ventures, in which companies contribute to the R&D capacities and a potential fund provides the money necessary for financing. Or a participation in new concepts such as public-private partnerships.
Commerzbank – including the risk department – is committed to be at the side of our clients in these times.

When uncertainty rules, as chief risk officer for Commerzbank, I firmly believe we can help our clients to master the challenges which ultimate will also create value for us.

Thank you!

Disclaimer

This transcript contains forward-looking statements. Forward-looking statements are statements that are not historical facts. In this release, these statements concern inter alia the expected future business of Commerzbank, efficiency gains and expected synergies, expected growth prospects and other opportunities for an increase in value of Commerzbank as well as expected future financial results, restructuring costs and other financial developments and information. These forward-looking statements are based on the management's current plans, expectations, estimates and projections. They are subject to a number of assumptions and involve known and unknown risks, uncertainties and other factors that may cause actual results and developments to differ materially from any future results and developments expressed or implied by such forward-looking statements. Such factors include the conditions in the financial markets in Germany, in Europe, in the USA and other regions from which Commerzbank derives a substantial portion of its revenues and in which Commerzbank holds a substantial portion of its assets, the development of asset prices and market volatility, especially due to the ongoing European debt crisis, potential defaults of borrowers or trading counterparties, the implementation of its strategic initiatives to improve its business model, the reliability of its risk management policies, procedures and methods, risks arising as a result of regulatory change and other risks. Forward-looking statements therefore speak only as of the date they are made. Commerzbank has no obligation to update or release any revisions to the forward-looking statements contained in this release to reflect events or circumstances after the date of this release.

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